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Supreme Court of the United States

OCTOBER TERM, 1944

No. 296

PANHANDLE EASTERN PIPE LINE COMPANY,
ILLINOIS NATURAL GAS COMPANY AND MICHIGAN
GAS TRANSMISSION CORPORATION, PETITIONERS,

vs.

FEDERAL POWER COMMISSION, CITY OF DETROIT,
COUNTY OF WAYNE, MICHIGAN, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT
OF APPEALS FOR THE EIGHTH CIRCUIT

PETITION FOR CERTIORARI FILED JULY 28, 1944.

CERTIORARI GRANTED JANUARY 3, 1945.

VOL. VII.
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United States Circuit Court of Appeals
EIGHTH CIRCUIT.

No. 12,466

**PANHANDLE EASTERN PIPE LINE COMPANY, A
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SERVICE COMMISSION, RESPONDENTS.**

**PETITION TO REVIEW AND SET ASIDE ORDER OF FEDERAL
POWER COMMISSION.**

FILED FEBRUARY 6, 1943.

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By Mr. Littman:

Q. The investors were, on that date, discounting the possibility of a rate reduction, were they not?

A. I cannot answer that question. I think there were notices in the press to that effect but I cannot say that the investors were discounting it.

Q. Can you state whether or not the investors on that date were anticipating higher taxes in 1942, and in 1941?

A. On what date?

Q. On the date as of which you computed your 8.4 percent "investor's appraisal of risk."

A. I think they were anticipating higher taxes for 1942.

Q. Were they anticipating higher taxes in 1941?

A. The bill was already out at that time.

Q. Yes; and they knew at that time that that bill, with the higher tax provisions in it, would apply to the revenues in the next year succeeding, did they not?

A. I understood that bill to apply to 1941 earnings.

Q. When you purchased securities on behalf of your banking institution in 1940, didn't you have pretty definitely in mind a tax increase to be applied for the year 1941?

A. Yes.

Q. Yes, and you discounted the present earnings because you knew that you could not expect to receive the earnings next year that you were receiving today, isn't that right?

A. I would not state it is just that way.

Q. Suppose you state it in your own language. We all know it to be axiomatic.

A. First, let me ask you—are you speaking of bonds or stocks?

Q. I am speaking of stocks.

A. You are speaking of stocks?

Q. Yes.

A. Well, I should say that in the purchase of stocks in 1940, we certainly were anticipating higher taxes for 1941. We had no way of knowing whether the net after taxes would be higher or lower for the year 1941. As a matter of fact, I think in many cases they were higher after taxes.

Q. And the earnings which you required on the securities in your portfolio were discounted for the increased tax rates that you knew were coming in 1941 when you purchased those securities in 1940, isn't that correct?

A. No, that is not quite correct. When a trustee purchases common stocks for a trust account, he is more likely to take a long-term view of the value of the securities than is perhaps an individual who makes such a purchase because it is much more likely that the trustee will continue to retain that stock through lower markets and through [fol. 8444] higher markets, provided the condition of the company, the position of the company and the excellence of its management and the return in dividends on his purchase remain favorable.

Q. You mean to say you ignore the fact that taxes are going up?

A. No, I did not say that.

Q. You take it into account, don't you?

A. Certainly.

Q. When you consider the earnings?

A. Yes, but there are many other factors, is what I mean to say.

Q. I did not mean to be wholly exclusive when I mentioned the item of taxes. That is one of the items, isn't it, that you consider? A. Yes, sir.

Q. And when you buy utility stocks during the course of a pendency of a rate investigation, you take into account the possibility of a rate reduction, do you not?

A. Yes.

Q. Now, this 8.4 percent earnings-price ratio reflects the earnings on the Class A cumulative preferred stock; does it not?

A. The 8.4 percent is the total income for 1940 after depreciation and taxes.

Q. Yes, and some of that income, a large part of it, as [fol. 8445] a matter of fact, went to service the Class A cumulative preferred stock of Panhandle Eastern, did it not?

A. Well, I repeat that the 8.4 percent is the earnings figure divided by the aggregate market value of all of the securities outstanding at that time.

Q. Now, at that time, how much cumulative preferred stock was outstanding of the Class A type?

A. Class A—100,000 shares.

Q. What was the market value?

A. There was ~~no~~ market for the stock and the only way I could get at the figure reasonably was to use its call price.

Q. What was the call price?

A. Par value \$100 and call price \$110.

Q. What is the total for that class of stock?

A. 100,000 shares—\$11,000,000.

Q. \$11,000,000. A. Yes.

Q. And none of that stock was outstanding in the hands of the public?

A. That is my understanding.

Q. The holding company, namely, Columbia Oil & Gasoline Corporation, owned all of that stock, isn't that right?

A. I believe that is correct.

Q. Then you do not have any real appraisal of earnings in so far as that stock is concerned, do you?

[fol. 8446] A. Not based on market quotations or sales.

Q. There were no market quotations and there were no sales, is that right?

A. That is my understanding.

Q. And you know that one of the things that the Securities and Exchange Commission was extremely anxious to get rid of was this \$11,000,000 of Class A preferred stock, don't you, in the capitalization of Panhandle Eastern?

A. I do not know the story back of the recapitalization.

Q. Do you know whether Panhandle Eastern Pipe Line Company itself was extremely anxious to get rid of that \$11,000,000 of Class A cumulative preferred stock?

A. No, sir, I am not familiar with their reasons.

Q. As a matter of fact, you know that that Class A stock had a participating dividend feature, do you not?

A. It is called a participating preferred.

Q. You know, do you not, that the holders of the Class A preferred stock had a right to participate in the dividends paid on the common stock, do you not?

A. I assume that that is the meaning of participating preferred. I do not know the terms.

Q. Do you know the Class A preferred stockholders had been receiving something like 10 percent on their holdings for the past few years?

A. No, sir.

[fol. 8447] Q. And assuming that to be the fact, all of that is reflected in your 8.4 percent, so-called "Investor's appraisal of risk", is it not?

A. I do not take it so, no.

Q. What would the 8.4 percent reflect, all of the earnings on all of the outstanding securities, doesn't it?

A. Yes, but it has no reference to where it goes. It might go to a 6 percent bond or 3 percent bond for interest charges, or it might go to 6 percent preferred or it might be held over for common stock. It is a net figure available for capital uses, capital charges.

Q. And one of the reasons why we are here today is to determine whether or not Panhandle Eastern is entitled to have that much available, namely, 8.4 percent, isn't that a fact?

A. Well, Michigan Gas Transmission Corporation is the case, as I understand it.

Q. All right. Well, that is another one of the reasons why we are here, of course, but one of the reasons is because we are going to ascertain whether or not the 8.4 percent it reasonable in the first instance, is that not right?

A. Are you telling me it is the case?

Q. I am asking you.

A. I do not know.

Q. Don't you know that the reasonableness of the rates of Panhandle Eastern Pipe Line Company is one of the [fol. 8448] main issues in this proceeding?

A. Well, so far as my testimony and study of the situation is concerned, I am familiar only in a general way with the Michigan Gas Transmission Corporation.

Q. Well, I appreciate that you have not offered any testimony on the question of rate of return applicable to Panhandle Eastern, but I am asking you whether you know or do not know whether the rates of Panhandle Eastern Pipe Line Company are, also, being investigated here in this proceeding?

A. My impression is that they are.

Q. Assuming that to be the fact, and I assure you it is, the rate of 8.4 percent is, itself, in question here, is it not?

A. I think you might say that, yes, at least the figures which produce the 8.4 are in question.

Q. Now, if that is the very question before us, we certainly cannot use the 8.4 percent as a guide for the determination of the reasonableness of that percentage in the first place, can we?

A. I think that is correct and that is the reason we left it out.

Q. That is why you left it out?

A. I spoke of it only because Mr. Lee, I think, brought up the question of actuality which I tried to answer for him, so far as I was able.

Q. Mr. Drew, at Page 1917 of the transcript, you make [fol. 8449] the following statement:

"Now, as to the bonds, the interest the first year would be \$225,500 which, I believe, would have to be covered at least five times after taxes."

Is that your testimony? A. Yes, sir.

Q. You have not changed your mind about that since you testified here on direct examination? A. No, sir.

Q. Notwithstanding the recent Panhandle Eastern financing?

A. No, sir.

Q. Now, will you show us any bonds that you consider comparable anywhere in the "Financial World" which has interest covered five times and is selling to yield at 3½ percent?

A. Well, I have not any comparable securities because there are so few natural gas pipe line bonds outstanding.

Q. Well, I ask you to give us one that you consider as comparable as possible. You have a list.

A. It is the same kind of thing, I believe.

Q. May I ask what you are now reading?

A. This is called "The Bond Tabulator", published by Nathan Publishing Company of New York City.

Q. Mr. Drew, may I interrupt for a moment, please?

A. Yes.

Q. Did you have any such company in mind when you [fol. 8450] testified on direct examination in this proceeding?

A. I had no one company in mind, no, sir.

Q. And you do not have any in mind, offhand, now, either, do you?

A. Not offhand, no. On that point, however, I think you would have to give some consideration, considerable weight to the fact that this would be a serial bond issue and the company has to make earnings to gradually retire the bond issue as well as to cover interest charges.

Q. Well, that would tend to make the bonds more secure than otherwise, would it not?

A. Well, on the point that we are talking about, it would tend to raise the necessary coverage of the interest rate of the bond.

Q. Would such a bond cost more than another kind.

A. Cost more.

Q. I refer to cost as interest.

A. You mean a serial bond?

Q. Yes, wouldn't the interest cost on a serial bond be greater than the interest on one without the serial provision, all other things being equal?

A. All other things being equal, I think it would be a little lower interest on the serial bond.

Mr. Baldridge: So we are clear on it, you used interest cost, Mr. Littman, and the witness used interest rate.

[fol. 8451] Mr. Littman: We are talking about the same thing.

Mr. Baldridge: Yes, but from different angles.

By Mr. Littman:

Q. Have you been able to find a bond in your bond list that has an interest coverage of five-times which yields 3½ percent?

A. Well, I perhaps could find some bonds of that character, but I would want to make a little further study to see whether I considered the companies comparable and the issue comparable.

Q. Well, didn't you first consider that before you testified on direct examination and used that factor in arriving at your claimed 8½ percent rate for this company?

A. Not in a specific way, no, for the reason that my work is pretty much inclusive of that sort of a consideration almost every day.

Q. Suppose you just name one or two bonds that you can find in your list or anywhere in the financial world, pipe line companies or otherwise, that have an interest coverage of five times and an interest yield of $3\frac{1}{2}$ percent on its bonds?

A. Well, without claiming that they are comparable to Michigan Gas Transmission Corporation, just looking this over, in order not to take too much time, here is Public Service Electric and Gas, first mortgage bonds, rated [fol. 8452] AAA covering their fixed charges $4\frac{1}{2}$ times and yielding 3.6 percent.

Q. What is the call price on that bond?

A. It is non-callable.

Q. What is it selling for?

A. This gives the market as 221, it is a high coupon bond, you see, it is a $4\frac{1}{2}$ percent coupon.

Q. You mean it is selling at, did I understand you to say, 221?

A. Yes. No, I am sorry, the interest rate is 8 percent on this particular bond, long-term, due in 2037, covers its fixed charges $4\frac{1}{2}$ times and yields 3.6.

Q. Are you giving the current yield or the yield at maturity?

A. The yield at maturity.

Q. The bond is selling at more than twice par, is it?

A. That is right.

Q. Incidentally, you would not make any claim that that is anything like comparable to Michigan Gas Transmission Corporation, would you?

A. No; I do not think so.

Q. What is the next one? By the way, the coverage is $4\frac{1}{2}$ times there, is it not?

A. Yes.

Q. You have used 5.

A. Yes, I was picking them when they were close. These [fol. 8453] are grouped by classification, so I have to step down to a 2A and a 1A to get your figures for you.

Q. By the way, isn't Public Service kind of stuck with that bond?

A. Well, of course, they would like to have it callable at about 105.

Q. Your answer to my question is yes?

A. Yes.

Q. You would not suggest that Michigan Gas Transmission Corporation be inflicted with that kind of a bond, would you?

A. No, sir.

Mr. Baldridge: Mr. Littman, while you are waiting between questions, I would like to suggest that if you want a real answer to that question about similar bonds, that you give Mr. Drew a little time to look them up because that is something that cannot be picked up in a few seconds.

Mr. Littman: We have been unable to find any comparable bonds of this character and we would like to have our curiosity satisfied with, at least, one example before Mr. Drew leaves the stand, if he will do it for us.

The Witness: Well, as I say, I would like to have more time to satisfy myself that they are comparable. That is the most difficult part of it.

By Mr. Littman:

Q. I hand you Standard & Poor's "Bond Investments" [fol. 8454] issue of September 6, 1941, and ask you to peruse that and see if you can find such a bond. If you find even one we would like to have you give that.

A. I do not see any on this list from a rapid examination of it.

Q. Thank you. Are you still searching for—

A. (Interposing) Shall I continue to do so?

Q. For just another minute, if you wish.

Mr. Drew, I believe you have been looking for about six or seven minutes. About how much longer will it take you to go through that list?

A. Well, to give you a real answer would take quite a time, because I would rather not try to reply without a pretty careful study of it.

Q. Yes. If you find any of such bonds, even if you can find one, we would like to have you advise us.

A. All right.

Q. How long would it take you to conclude your study?

A. Oh, three or four hours, I should think.

Q. Could you do that upon your return to Chicago?

A. Yes.

Q. And let us know next week?

A. Yes.

Mr. Baldridge: Does that mean you are going to want Mr. Drew back?

[fol. 8455] Mr. Littman: No, he can write a letter.

By Mr. Littman:

Q. Now, am I correct in understanding that the one bond to which you have referred that has an interest coverage $4\frac{1}{2}$ times, namely, the Public Service Electric and Gas Company bond, imposes an undue burden, does it not, upon that company?

A. I do not believe it is a very important burden. There is only \$7,600,000 outstanding and it is quite a large company.

Mr. Littman: Will you read that answer?

(Whereupon, the last answer was read by the reporter.)

By Mr. Littman:

Q. What is the amount of bonds that you propose under your assumption from the capital structure for Michigan Gas?

A. $6\frac{1}{2}$ million.

Q. About the same amount?

A. Well, it is about the same amount, but it is half the capitalization, whereas the company I just referred to is quite a different situation.

Q. In other words, it would be an extremely heavy burden on a company where 50 percent of its capital structure is represented by such character of bonds.

A. Certainly.

Q. And your suggested capital structure for Michigan Gas Transmission contemplates a 50 percent bond structure, does it not?

A. Yes, sir. The Fitch Bond Record, Mr. Littman, shows the total debt of Public Service Electric and Gas is \$175,000,000 debt alone, therefore, that was the reason for my remark that \$7,600,000 is a small part of it.

Q. Now, can you show us any bond that you consider comparable anywhere in the financial world which has interest covered four times and selling to yield $3\frac{1}{2}$ percent?

A. Shall we handle that the same way as the other?

Q. Suppose you look for the four times bond now.

A. Providence Gas Company, first mortgage 4 percent bonds, covering the charge 4.6 times and yielding 3.59.

Q. What is that bond selling for?

A. 106 bid.

Q. What is the callable price?

A. 103.

Q. The bond is selling well above call price, is it not?

A. Yes.

Q. Do you know what the prospects of its being called are?

A. No. You see I am only picking these out of a chart. I haven't had a chance to study these, obviously.

Q. You would not consider that comparable to Michigan Gas?

A. I cannot answer that without further study.

Trial Examiner: It is clear you will not conclude your [fol. 8457] cross-examination of Mr. Drew today and I suggest, if you have some other similar requests, you submit them now and, as a matter of saving time, get the answers in the morning.

Mr. Littman: Yes, I have this request.

Can you show us any company anywhere in Mr. Coffman's Exhibits No. 63 and No. 64, which earns its interest requirements five times and whose bonds are selling to yield 3½ percent?

[fol. 8461] FRED A. SPITZNAGLE a witness, having been previously duly sworn, resumed the stand and testified further as follows:

Cross-examination (Resumed).

By Mr. Chamberlain:

Q. Mr. Spitznagle, Indiana Gas Transmission Corporation had its line of some 122 miles in operation throughout the year 1932, did it not?

The Witness: It was in operation the whole of the year 1932.

[fol. 8462] Q. That is sufficient; and the line in 1932 extended as far [waist] as King measuring station near Muncie, did it not?

A. Is that information in Exhibit 91?

Q. Yes, I think that is factual, too. At the very bottom of Page 13 it states there were 52.4 miles of 18-inch line extending from Zionsville to a point known as King measuring station located adjacent to Muncie, Indiana.

A. That is right.

Q. Referring to your Exhibits 101 and 103, let me ask whether the sale of gas by Indiana Gas Transmission Corporation and, for the moment, we will confine ourselves to the first two months of 1936, were made wholly to gas utilities or what we know as distributing utilities?

Mr. Baldridge: Are you including in that municipalities?

Mr. Chamberlain: Yes, Mr. Baldridge.

The Witness: That is correct, yes, sir.

Q. Now, in 1936, if the two affiliated companies to which Indiana Gas Transmission was selling gas be eliminated, it had five customers?

A. On the assumption that the only affiliations are Indiana Gas Distribution Corporation and the Ohio Fuel Gas Company. I make that qualification because I am not familiar with these names in relation to the Columbia system.

[fol. 8463] Q. Yes. Now, at that time and I speak again with reference to the first two months of 1936, Indiana Gas Transmission Corporation had a connection with the properties of the Central Indiana Gas Company, did they not?

A. That is one of the companies being served by Indiana Gas Transmission Corporation.

Q. And it is still being served by them?

A. Yes.

Q. They also had a connection with the Indiana-Ohio Public Service Company?

A. Yes, sir, that is true.

Q. And, in each instance that I will quote here, they are still serving them, are they not?

A. That is true, yes.

Q. Bendleton Natural Gas Company, they are still serving that company, are they not?

A. Yes, sir.

Mr. Baldridge: As of what date was that, Mr. Chamberlain?

Mr. Chamberlain: The first two months of 1936.

By Mr. Chamberlain:

Q. At that time, they had connections with the properties of the Public Service Company of Indiana, did they not? A. Yes, sir.

Q. And they are still serving them?

A. Yes, sir.

[fol. 8464] Q. Then the only additional customer was that of the Montezuma, the only additional customer?

A. In the first two months of 1936, that is correct.

Q. And they are still serving that municipality?

A. That is correct.

.

Mr. Witness, your exhibits show that up to the present time, do they not, that Michigan Gas Transmission is serving each of these five customers?

The Witness: The exhibit shows that, yes. Not up to the present time.

.

Q. Now, Mr. Spitznagle, you have divided the year 1936 into two parts, the first of which shows the sales by Indiana Gas Transmission Corporation during the first [fol. 8465] two months of the year and, under the name of Michigan Gas Transmission Corporation, for the latter part of the year. There are certain changes in the second period caused by additions of customers, are there not?

A. Yes, sir.

.

[fol. 8466] Q. Now, what amount of gas was sold by Indiana Gas Transmission to these consumers during the two month period?

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[fol. 8467] A. The M.c.f. sales in the first two months of 1936 made by Indiana Gas Transmission Corporation to all companies except Indiana Gas Distribution Corporation and Ohio Fuel Gas Company were 480,776 M.c.f.

Q. May I suggest a correction there? You may be right, but I have 490,776, if you will check that. I may be wrong.

A. You are right, 490,776 M.c.f.

Q. Yes.

A. The dollar amount responsive to those M.c.f. sales I determine as \$155,059.31.

Yes, I see I picked up a wrong figure. \$159,161.31 is correct.

Now, the revenue per M.c.f., between 34.4 and 34.5 cents per M.c.f. Is that close enough?

Q. I am afraid it is against you, Mr. Spitznagle. I have 32.43.

[fol. 8468] A. The figure is 32.43 cents per M.c.f.

Q. Now, that was the average price which was collected during that period for gas sold to those whom we termed to be non-affiliates?

[fol. 8469] Q. (Interposing). If you will do that, I shall change the question and ask for them in order. No. 1 is Central Indiana Gas Company. What was the revenue per M.c.f.?

A. 30.976 cents.

Q. The revenue from Indiana Gas Distribution Corporation, which is the affiliated company?

A. 50 cents.

Q. The revenue from Indiana-Ohio Public Service Company?

A. 50 cents.

[fol. 8472] Q. Now, what was the revenue derived during this period from Ohio Fuel Gas Company?

A. 22½ cents per thousand cubic feet, that is.

Q. Yes; and that, as was indicated, was a large account of, apparently a temporary nature?

A. I do not know how temporary it was. It was an account that did not continue after 1936 in any large quantities.

What was the revenue per M.c.f. from Pendleton Natural Gas Company?

A. 55 cents per thousand M.c.f.

Q. And from the Public Service Company of Indiana?

A. 35.611 cents per thousand M.c.f.

Q. And from the Town of Montezuma, Indiana?

A. 52.035 cents per thousand M.c.f.

Q. Now, I would like to get in the record the results of the year 1936 both with respect to the sales, sales revenue and revenue per M.c.f. and the additional customers [fol. 8473] that were procured during that year. What customers were added in the year 1936 after the first two months of the year?

A. Kentucky Natural Gas Corporation; Lynn Natural Gas Company; the Town of Lapel, Indiana, the Town of Pittsboro, Indiana, and the Town of Roachdale, Indiana, and the Michigan Consolidated Gas Company, Detroit.

[fol. 8474] Q. Now, to make that comparable, would [would] read in the revenue per M.c.f. for each one of those customers?

A. Central Indiana Gas Company—30.199 cents,
Indiana Gas Distribution Corporation—29.003 cents,
Indiana-Ohio Public Service Company—50 cents,
Kokomo Gas and Fuel Company—26.5 cents,
Lynn Natural Gas Company—50 cents,
Ohio Fuel Gas Company—22.296 cents,
Pendleton Natural Gas Company—55 cents,
Public Service Company of Indiana—34.446 cents,
Town of Lapel, Indiana—49.629 cents,
Town of Montezuma, Indiana—50.461 cents,
Town of Pittsboro, Indiana—53.021 cents,
Town of Roachdale, Indiana—52.368 cents.

[fol. 8477] Q. Now, with the understanding, Mr. Spitz,
[fol. 8478] nagle, that the detail of the sales in M.e.f., the
revenue and the revenue per M.e.f. for the years 1937, 1938,
1939 and 1940 and for the 12 months ending June of 1941
will be set out in a detail to be later presented to you, I
wish to ask you to state into the record the total sales per
M.e.f. for each of these four or five twelve-months' periods
and at the same time give the revenue derived per M.e.f.

[fol. 8479] Q. With the exclusion of the two affiliates.

A. With the exclusion of the two affiliates.

For the year 1937 the M.e.f. sales, excluding the Indiana
Gas Distribution Corporation and Ohio Fuel Gas Com-
pany, were 6,700,042, the revenue per M.e.f. was 27.316
cents;

For the year 1938 the M.e.f. sales were with the fore-
going exclusions, 6,558,681, the revenue per M.e.f. was
28.218 cents;

For the year 1939 the M.e.f. sales were, with the fore-
going exclusions, 9,142,406 and the revenue per M.e.f. was
26.952 cents;

For the year 1940 the total M.e.f. sales, with the forego-
ing exclusions, were 10,096,976 and the revenue per M.e.f.
[fol. 8480] was 27.903 cents;

For the 12 months ended June 30, 1941, with the fore-
going exclusions, the total M.e.f. sales were 11,344,051, the
revenue per M.e.f. sales was 27.7 cents.

[fol. 8481] Q. I would like to have you state one more
thing and that is for each of the five annual periods that
you have just covered give the sales in M.e.f. without de-
duction for the affiliates and the revenue per M.e.f. result-
ing therefrom.

A. For the year 1937 the M.e.f. sales to other gas
[fol. 8482] utilities were 7,078,054, the revenue per M.e.f.
of those sales was 27.375;

For the year 1938 the M.e.f. sales were 7,680,735 and the
revenue per M.e.f. was 28.152 cents;

For the year 1939 the M.c.f. sales were 10,355,402 and the M.c.f. revenue per M.c.f. was 27.066;

For the year 1940 the M.c.f. sales were 11,364,929 and the revenue per M.c.f. of sales was 27.775;

For the 12 months ended June 30, 1941, the M.c.f. sales were 12,692,888, and the revenue per M.c.f. sales was 27.429 cents.

Q. Mr. Spitznagle, the same information with respect to the year 1941 is found in Exhibit 164, is it not?

A. Yes, sir.

Q. And in that exhibit there is a division between the sales to affiliates and non-affiliates?

A. Yes, sir.

Q. Now, in order that this page of the record may be complete to the year 1941, will you give the same figures with respect to the quantity of sales and the resulting price per M.c.f. as a total and, also, without the affiliates?

A. Excluding the afore-mentioned affiliates, the M.c.f. sales for the 12 months ended December 31, 1941, were 13,145,792; and the revenue per M.c.f. of those sales was 27.21 cents.

[fol. 8483] Including the afore-mentioned affiliates, the sales in M.c.f. were 14,458,013 and the sales per M.c.f. responsive to the M.c.f. sales was 26.97 cents per M.c.f.

[fol. 8484] Q. All right. Now, just one more question. Did you have time to check the figures on Exhibit marked for identification as No. 165?

A. 165 or 166?

Trial Examiner: 165 is the prospective budget.

Mr. Chamberlain: Exhibit 166.

The Witness: Yes, sir, I did.

By Mr. Chamberlain:

Q. To what extent were you able to check them, Mr. Spitznagle?

A. I found all of the information shown in that exhibit correct. I was not able to check the last line captioned, "Indiana Gas Distribution Corporation", for the

reason that no information is in the offices of Michigan Gas Transmission Corporation with respect to that transaction.

[fol. 8485] Q. That is as I anticipated. Otherwise, the quantities shown there are correct?

A. Yes, sir.

Mr. Chamberlain: The Intervenor then offers in evidence Exhibit 166 with the exception of those figures contained in the last line entitled, "Indiana Gas Distribution Corporation" which may be stricken from the exhibit.

Trial Examiner: I have heard no objection to the reception in evidence of this exhibit.

Trial Examiner: The tabulation marked for identification as Exhibit No. 166 will be received in evidence, with the modification which was stated by Mr. Chamberlain, as Exhibit No. 166.

(Exhibit No. 166 was received in evidence.)

Q. Were you able to pick up the gas revenues for the years 1931 to 1935, Mr. Spitznagle?

A. Yes, sir.

Q. What then, were the gas revenues for those years of Indiana Gas Transmission Corporation?

[fol. 8486] A. Exhibit 166 shows both purchases and sales of gas and I am wondering if you do not wish to correct your question to include both so that I could give you the dollar amount responsive to M.c.f. in each of the Columns 1931 to 1935, inclusive?

Q. That is exactly correct, but I had assumed the figures you would find more easily would be the gas revenues which would cover all of the gas sold by each of the companies. If you have it broken down, I will be glad to have it.

A. In Column 1931, the dollars responsive to 265,077 M.c.f.'s is \$47,713.86.

The M.e.f. amount of 12,212 and the dollar amount is \$2,747.70.

The Column 1932, the dollar amount responsive to the 1,834,120 M.e.f. was \$330,141.60.

The dollar amount responsive to the 215,048 M.e.f.'s is \$48,385.81.

The dollar amount responsive to the 1,521 M.e.f. is \$760.45.

The dollar amount responsive to the 2,336 M.e.f. is \$1,097.92.

In the column headed "1933," the dollar amount responsive to the 1,611,437 M.e.f.'s is \$290,058.66.

[fol. 8487] The amount responsive to the 55,384 M.e.f.'s is \$12,461.41.

The amount responsive to the 7,428 M.e.f.'s is \$3,714.

The column headed, "1934", the dollar amount responsive to the 1,726,349 gives \$310,742.82.

[fol. 8488] The Witness: We were talking about the column headed "1934".

[fol. 8489] The 84,034 M.e.f.'s is responsive to the dollar amount of \$18,907.67.

The dollar amount responsive to [to] 13,029 M.e.f.'s is \$6,514.50.

The dollar amount responsive to the 3,370 M.e.f.'s is \$1,583.90.

The column headed "1935", the dollar amount responsive to the 2,369,654 M.e.f.'s is \$426,537.72.

The dollar amount responsive to the 315,964 M.e.f.'s—

A. 315,984 M.e.f.'s is \$71,096.42.

The dollar amount responsive to the 25,279 M.e.f.'s is \$12,639.50.

The dollar amount responsive to the 37,195 M.e.f.'s is \$17,481.65.

Q. Now, I am lacking one set of figures that I need to complete that and on which I think perhaps my question lacked clarity, and that would be the gas revenues of Indiana Gas Transmission Corporation. The exhibits which have been introduced in this proceeding on behalf of Panhandle Eastern have covered the period from April 1, 1932, to date, and, in order to work these up in a comparable way, I should like to ask you, upon your return [fol. 8490] to the stand, to give the amount of gas revenues received by Indiana Gas Transmission Corporation from the time of the commencement of business until the end of February 1936, by years.

Mr. Littman: Mr. Examiner, we have no further questions to ask Mr. Spitznagle at this time. However, during the course of his cross-examination, I asked him to state the names of the present members of the Board of [fol. 8491] Directors of Michigan Gas Transmission Corporation and the officers of that company. He stated he did not know but counsel suggested—

Mr. Culton: (Interposing) He is in a position to give them to you.

Mr. Littman: Do you have those now?

The Witness: Yes, I can give them to you.

Mr. Littman: Mr. Spitznagle, will you please give us the names of the present members of the Board of Directors of Michigan Gas Transmission Corporation?

The Witness: The names of the Board of Directors of Michigan Gas Transmission Corporation as of today, February 28, 1942, are: Joe D. Creveling, W. G. Mortland, R. C. Patterson, Jr., W. G. McGuire and H. H. Heimann.

Mr. Littman: Who is Chairman of the Board?

The Witness: That I do not know.

Mr. Littman: When were these Directors elected?

The Witness: Prior to today and after—I do not believe I have that information.

Mr. Littman: Perhaps Mr. Young has the information.

Could you give us the date on which these members were elected to the Board of Directors?

Mr. Young: I believe, February 6, 1942.

Mr. Lee: Are any of these Directors you have just named also Directors at the present time of Panhandle [fol. 8492] Eastern Pipe Line Company?

The Witness: Perhaps so, but I am not very well acquainted as to who the officers and Directors of Panhandle Eastern Pipe Line Company are.

Trial Examiner: Does counsel care to complete that statement?

Mr. Culton: I think all of them are but I would not say that definitely. I know some of them are.

Mr. Lee: Are any of these Directors whom you have just named Directors of Columbia Gas & Electric or Columbia Oil Company or any of its affiliates?

The Witness: I would have no information on that.

Mr. Culton: None so far as I know. Mr. Baldrige answers the same way. How about you, Mr. Young?

Mr. Young: I do not believe any of them are on the Board of Directors.

Trial Examiner: These statements are a bit vague. I do not know what Mr. Littman has in mind but the statement is vague and I think—

Mr. Littman: (Interposing) I was going to have him next name the present officers of Michigan Gas Transmission Corporation.

Trial Examiner: Do counsel care to supply the information just suggested?

Mr. Culton: If I am wrong and there are any of these [fol. 8493] Directors who are not also Directors of Panhandle Eastern Pipe Line Company, we will advise the Examiner. As I stated, my understanding is that all of

them are also Directors of Panhandle Eastern Pipe Line Company.

Trial Examiner: The point is, we should not have to waste any time on the record to get those simple facts.

Mr. Culton: I don't know.

Trial Examiner: You will supply the information?

Mr. Culton: We will advise you if there is one of them who is not a member of Panhandle Eastern's Board and, frankly, we know nothing about any of them being members of either of the Columbia Boards.

Mr. Littman: In other words, we may assume, unless advised to the contrary, that all of the present members of the Board of Directors of Michigan Gas are also members of the Board of Panhandle Eastern Pipe Line Company, is that right?

Mr. Culton: That is right. That is your understanding, Mr. Young?

Mr. Young: Correct.

Mr. Littman: Mr. Spitznagle, will you please give us the names of the officers of Michigan Gas Transmission Corporation?

The Witness: The officers of Michigan Gas Transmission Corporation as of today, February 28, 1942, are: Joe D. Creveling, President; Gerard J. Neuner, Vice-President; [fol. 8494] George S. Young, Vice-President; Leith V. Watkins, Secretary; Louis F. Sperry, Treasurer; Charley D. Jellings, Assistant Secretary; Norman F. Paxton, Assistant Secretary; L. J. Mueller, Assistant Treasurer; and Norman F. Paxton, Assistant Treasurer.

Mr. Littman: We have no further questions.

Mr. Lee: Are all of these officers at the present time of Michigan Gas Transmission likewise officers of Panhandle, holding a corresponding position in Panhandle as they do in Michigan Gas?

Mr. Culton: Except for Mr. Young and Mr. Mueller, that statement is true.

[fol. 8525] GEORGE S. YOUNG, a witness, having been previously duly sworn, resumed the stand and testified further as follows:

Cross-Examination (Continued)

By Mr. Littman:

Q. Mr. Young, when you were last on the stand, I requested you to supply certain information and I shall now take up the items—

Mr. Culton: Don't you have that in written form?

The Witness: Yes, I have.

Mr. Culton: Would you hand it to him? Would it be satisfactory to put it in and cross-examine from that?

Mr. Littman: I believe it would be better to put this information in by question and answer.

Mr. Culton: I thought it might expedite it.

By Mr. Littman:

Q. I ask you to state the leakage on Line D and its laterals which lines have, until this month, been owned by Ohio Fuel Gas Company and operated by Michigan Gas Transmission Corporation. Do you have those figures?

A. I do.

Q. Will you please give them at this time?
[fol. 8526] A. The leakage from Line D extending from Muncie to the Indiana-Ohio State line and from the lateral extending from Line D to a point near Winchester, Indiana, was, for the year 1937,—34,300 M.c.f.

For the year 1938—50,600 M.c.f.;

For the year 1939—24,800 M.c.f.;

For the year 1940—18,100 M.c.f.

In October of 1941, the City of Richmond, Indiana, commenced to take natural gas from the Panhandle Eastern Pipe Line Company and, for the year 1941, the leakage of 28,200 M.c.f. includes the leakage from the lateral serving Richmond and from the short length of additional 16-inch pipe line in the State of Ohio which ties in with the Richmond lateral.

Q. You are speaking of the lines which have recently been acquired by Panhandle Eastern Pipe Line Company from Ohio Fuel Gas Company?

A. That is correct.

Q. Do I understand these leakage figures to represent the difference between the input at King station near Montezuma and the amounts delivered at the various border stations of the various towns served?

A. That is correct. King station is located near Muncie instead of Montezuma.

Q. The figures that you read for the years 1937 to 1940, inclusive, are comparable, are they not?
[fol. 8527] A. That is correct.

Q. But the figure that you read for the year 1941 is not strictly comparable because of the additional lines that were operated in Ohio?

A. By reason of the Richmond delivery, that is correct.

Q. And in the operation of taking over the new lines, to which you have just referred, was there any leakage, I mean to say in making the physical connection?

A. Yes, there may have been some which is not included in this figure.

A block valve which was located very close to the State line has been moved to east of the point where the Richmond lateral takes off and in connection with that shift, as well as in connection with the shift of a measuring station, there was some loss of gas but that is not included in this figure. It was estimated.

Q. That particular loss of gas was occasioned by line purging, was it not?

A. Line blowing, I understand, rather than line purging.

Q. You were also going to furnish data with respect to the repairs made by Michigan Gas on Line D and its laterals. Will you please give us that information?

A. Michigan Gas Transmission Corporation assumed the operation and maintenance of the pipe lines referred [fol. 8528] to in 1936. Our records show that between August 11, 1936 and February 5, 1942, a total of 938 draw bands were installed on the 16-inch pipe line to stop leak-

age and two collar leak clamps have been installed to close leaks in the couplings.

Q. Mr. Young, can you give us the number of those draw bands and leak clamps installed by years?

A. I could furnish that. I do not have it broken down here. It could be furnished, however.

Q. Will you please do that? If you are not available on Monday you may supply it to your counsel who can read it into the record.

A. Very well.

Q. Are any of these repairs which you have just mentioned called coupling repairs?

A. Yes, the installation of the collar leak clamps are coupling repairs.

Q. Will you also furnish us the years in which the two collar leak clamps were installed?

A. Very well.

Q. Now, you have not as yet completed giving all the information with respect to repairs, have you?

A. No.

Q. Will you continue?

A. None of the 16-inch pipe in this pipe line has been replaced except in connection with the installation of an [fol. 8529] orifice meter setting and a main-line valve. Since August, 1936, 16 draw bands have been installed to close leaks in the pipe wall and one sleeve has been installed to close a leak in a coupling on the 6-inch lateral pipe line extending to Winchester, Indiana, from the 16-inch pipe line.

A. You will supply the years in which those draw bands and sleeves were installed, will you not?

A. Yes, sir.

Q. Now, you just stated with respect to my request for data relating to whether any pipe was replaced on these lines, that certain pipe was replaced. Will you state where that pipe was replaced?

A. It was at the location where the block valve and the measuring station had been installed prior to the time that the Richmond market was attached.

Q. You mean that was at a point near the Ohio-Indiana State line?

A. That is correct.

Q. Which point was the terminal point of the 16-inch line in 1941?

A. In October.

Q. Now, you say no other pipe has been replaced on these lines?

A. No.

Q. This statement applies from the date in 1936 when [fol. 8530] your company began to operate this line down to date, does it not?

A. Down to the end of 1941.

Q. Do you know whether Ohio Fuel Gas Company made any replacements on these lines since 1936?

A. They have not except on the pipe line leading to Richmond, on the lateral pipe line leading to Richmond, and before that was taken over by us for operation and the Richmond market was attached, they made repairs and replacements in that pipe line—I am speaking of the lateral—in the year 1941.

Q. In the year 1941?

A. That is correct.

Q. Do you know the extent of the replacements made?

A. I have a record indicating changes were made. I do not know how correct it is or whether it represents what was actually done but I do have a map showing the changes that were purported to have been made.

Mr. Baldridge: That line was extensively rehabilitated, was it not?

The Witness: It was extensively rehabilitated.

Mr. Baldridge: That was in 1941?

The Witness: In the fall of 1941 prior to the time that the Richmond, Indiana, market was attached.

Mr. Baldridge: But that rehabilitation was not done by [fol. 8531] Michigan Gas Transmission Corporation?

The Witness: No, that was done by Ohio Fuel Gas Company.

Mr. Baldridge: And you have no direct knowledge of that?

The Witness: I have no direct knowledge. I have a map, though, indicating where replacements were made.

By Mr. Littman:

Q. Do you have any idea how many lengths of pipe were replaced?

A. I do not at this time.

Q. What is the length of that line, the Richmond line, approximately?

A. About 12 miles.

Q. You do not know how many miles of pipe were replaced?

A. I do not, at this time.

Q. Could you readily ascertain that?

A. Yes, that is, as can be ascertained from this map that I have.

Mr. Culton: Does the map show the number of pipe lengths?

The Witness: It was a 10-inch pipe line and, in rehabilitating it, they substituted 8-inch where replacements were necessary. The map which I have shows the amount of 8-inch line put into the pipe line.

By Mr. Littman:

Q. If you will furnish that to counsel, we will then have the statement in the record. I understand you are not [fol. 85;2] going to be in town next week.

A. That is correct.

Q. Now, what is the source of the data which you have given with respect to these repairs and replacements?

A. The source is from reports which have been furnished to the Detroit office of the Michigan Gas Transmission Corporation by our field men. I am referring to the repair work done on the 16-inch line in the State of Indiana and to the later D-172 going to Winchester.

Q. What is the manner in which that data has been supplied?

A. It is furnished on periodic reports submitted by the field foreman.

Q. And those reports are on file in your Detroit office?

A. They are.

Q. You were going to furnish us the location of a leak on Line A. Are you prepared to give us that information?

A. Yes.

Q. Very well.

A. One leak was located in Section 2, Union Township, Parke County, Indiana, at a point about 17 miles east of the Montezuma compressor station. A second leak was located in Section 20, Jackson Township, Putnam County, at a point about 31 miles east of Montezuma compressor station.

Q. Can you give us the station number?

[fol. 8533] A. I am unable to identify those by station numbers at this time.

Q. You could secure that for us, couldn't you?

A. Approximately, yes. I could get the approximate station number, but I do not think I could tie it down exactly.

Q. Were these two leaks on the new 24-inch loop line or on the old 20-inch line?

A. They are on the old 20-inch line.

Q. Both of them?

A. Both of them.

Q. Do you know how these leaks were repaired?

A. Yes, they were repaired by draw bands.

Q. I also requested you to advise whether all of the present lines of Michigan Gas Transmission Corporation were in service on March 18, 1941, which was the day of highest delivery in the winter 1940-1941. Do you have that data?

A. Yes. All were in operation on that date except the 6-inch loop line which partially parallels the Fort Wayne, Indiana, lateral.

Q. I also requested you to supply certain data with respect to your Exhibit 79. Have you prepared a schedule in accordance with my request?

A. I have.

Q. Do you have copies available for distribution?

A. Yes.

[fol. 8534] Trial Examiner: Very well. This tabulation will be marked for identification as Exhibit No. 79-A because it is related to Exhibit No. 79 which was received in evidence on February 26.

(The Document Was Marked Exhibit No. 79-A For Identification.)

Mr. Littman: The title of this exhibit is "Michigan Gas Transmission Corporation-Comparison of Daily Provided Capacity, to Deliver Firm Gas with Maximum Daily Delivery of Firm Gas and Total Delivery of Gas from Pipe Lines Owned or Operated by Michigan Gas Transmission Corporation for the Winter Period of 1941-1942 to Date, February 27, 1942".

I would like to have marked for identification as Exhibit 79-B a single schedule entitled, "Michigan Gas Transmission Corporation-Total Delivery of Gas from Pipe Lines Owned and Operated by Michigan Gas Transmission Corporation on Days on Which the Delivery of Firm Gas from System was the Maximum."

Trial Examiner: It will be marked as indicated.

(Exhibit No. 79-B was marked for identification.)

By Mr. Littman:

Q. Mr. Young, I hand you a copy of Exhibit 79-A and Exhibit 79-B and ask you whether you prepared those two schedules in response to my requests of recent date.

A. They were prepared under my supervision.

Trial Examiner: Do you wish to offer them in evidence Mr. Littman?

Mr. Littman: Yes, I would like to offer Exhibits 79-A and 79-B in evidence.

Mr. Baldrige: No objection.

Trial Examiner: These tabulations, marked, respectively, Nos. 79-A and 79-B, will be received in evidence without objection.

(Exhibit Nos. 79-A and 79-B were received in evidence).

By Mr. Littman:

Q. Now, Exhibit No. 79-A relates to the peak day that has occurred to date during the present winter, does it not?

A. During the winter of 1941-1942.

Q. Exhibit 79-B relates to the various peak days of the winter periods 1936 down to date, does it not?

A. Yes. Exhibit 79-B indicates the total deliveries from the pipe line system owned and operated by Michigan Gas [fol. 8536] Transmission Corporation in the winter periods to which you have referred.

Q. Now, will you please refer to Exhibit 79-A? You show in Column E, "Maximum total delivery of gas in M.c.f." to be a total of 175,435 M.c.f., do you not?

A. That is correct.

Q. Am I correct in understanding that that shows the total actual deliveries on that date?

A. That is correct.

Q. That is on February 27?

A. January 7, 1942. That is referred to in the footnote, Mr. Littman.

Q. In other words, January 7, 1942, is the day of highest demand that has occurred thus far in the present winter?

A. That is correct, that is as to total delivery.

Q. Yes. Now, in Column D you show the "Maximum daily delivery of firm gas, M.c.f." to be 150,210, do you not?

A. That is correct.

Q. Am I correct in understanding that the difference between columns D and E represents industrial gas? That is to say, not firm gas?

A. That is correct.

Q. Does the difference, to wit 25,225 M.c.f. represent the interruptible gas?

A. That is correct.

[fol. 8537] Q. Now, in Column C you show "Provided daily capacity to deliver firm gas-M.c.f." in the amount of 162,240 M.c.f., do you not?

A. That is correct.

Q. It is apparent that you did not mean by that heading to say that that is the total amount of firm gas that you could deliver.

A. Yes, that is the total amount of firm gas which we feel that we could deliver under any and all conditions which might prevail with regard to the delivery.

Q. Well, you could deliver more than 162,240 M.c.f. of firm gas if you had the market, could you not?

A. Under certain conditions, yes.

Q. What are those conditions?

A. In the winter period of 1940-1941 as a result of the operations and our experience it was decided that it is advisable to have a spare unit, that is, a spare compressing unit in each one of the compressor stations belonging to the Michigan Gas Transmission Corporation not only to serve in case of failure of any one unit in a station but, also, to serve in case the pressure conditions obtaining are such that the units, compressing units in each compressor station cannot be loaded to the maximum rated horsepower.

Now, to the extent that the spare unit is available and to the extent that the conditions obtain which will permit [fol. 8538] utilization of all of that horsepower, we can deliver additional gas. That is indicated by the fact that under Column C, while we feel that we have provided for a delivery of firm gas amounting to 162,240 M.c.f.'s, we were able to utilize the spare horsepower, in part, and actually deliver 175,435 M.c.f.'s on January 7 of this year.

Mr. Culton: May I ask a question?

Mr. Littman: Yes.

Mr. Culton: I think it is appropriate. Does the hourly regularity with which the gas is taken have anything to do with your ability of delivery?

The Witness: It does. That is one of the reasons why we felt it was necessary to install spare horsepower in these compressor stations.

Mr. Culton: In other words, if it is all taken with the same regularity, your daily capacity would be substantially in excess of what it would be if there were irregularity in the hourly withdrawals?

The Witness: If you refer to Column K in Exhibit 79, it is shown there that the provided daily capacity to deliver firm gas is 159,850 M.c.f.'s. If that gas could have been delivered at uniform hourly rates, then the markets listed in that column could have been supplied with one less gas engine and compressing unit in each of the three compressing stations.

I might, also, add that this end of the line is a critical [fol. 8539] end of the line. If there is a break or inter-

ruption of any kind or if there is a failure in a compressing station, it is more critical than it is to have a similar outage farther west.

Q. Mr. Young, let's look at Line 13 of Exhibit 79-A, which shows the deliveries to Fairmount. You show a provided daily capacity to deliver firm gas of 1500 M.c.f.'s, yet you did, in fact, deliver on January 7, 1942, more than twice that amount, namely, 4,995 M.c.f.'s. Is not that correct?

A. That is correct.

Q. Now, suppose you had had a firm market for 4,995 M.c.f.'s, you could have delivered that quantity of gas, could you not?

A. Yes, provided this spare unit which I referred to had been available.

Q. Had been available?

A. Had been available, as it was in this case.

Q. It was available?

A. Yes, it was in this case, and provided the pressure conditions obtaining at the compressing stations were such that the horsepower which we utilized—

Q. (Interposing) You see the difficulty we had with interpreting the meaning of your heading in the columns in Exhibit 79 and in Exhibit 79-A, "Provided daily capacity [fol. 8540] to Deliver Firm Gas-M.c.f." You do not mean by that heading, do you, that Michigan Gas Transmission Corporation could not have delivered more firm gas than the amount shown under that heading?

A. I mean by that heading that that delivery of firm gas could be made under most any conditions that might prevail, that is, under most any conditions that might prevail providing none of these units are out of service. I am referring now to the rate of hourly delivery that might prevail.

Q. The same situation that I described for Fairmount is generally true with respect to Muncie, is it not?

A. That is correct.

Q. You claim that you had a provided daily capacity to deliver firm gas of 8,200 M.c.f.'s, yet you did, in fact, deliver 21,345 M.c.f.'s on January 7, 1942. Is not that right?

A. That is correct and if all of the conditions which prevailed on that date, January 7, 1942, would prevail on every other day when we would be called upon to make a heavy delivery, then it would be proper to say that the deliveries listed in Column E could be firm deliveries.

Q. Well, whether all of those precise conditions prevailed or not, you do not doubt that you could deliver more than 8,200 M.c.f.'s of firm gas to Muncie, if you had the market?

A. I doubt whether we could deliver more if these conditions which I speak of did not prevail.

Q. Well, what conditions?

A. For that condition to prevail all of the gas engine compressing units which have been installed in these compressing stations must be in condition to operate. The other condition that must prevail is that the pressure conditions at these compressing stations are such that all of the horsepower installed there can be utilized. I might amplify the latter part of that statement a little bit by stating that sometimes, because of pressure conditions in a station, possibly only 1,000 out of a possible 1,300 horsepower in one of these compressing units can be utilized.

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Q. Don't you think your heading, "Provided Daily Capacity to Deliver Firm Gas M.c.f." is somewhat misleading?

A. No, I do not think it is, Mr. Littman. It is intended to provide capacity, it is intended to indicate that there is capacity to deliver the amounts of gas listed under it.

Q. Well, there is not any question in your mind, however, that if you had the market to deliver firm gas in the quantities shown in Column E of Exhibit 79-A you would have had the capacity to do it and could have delivered [fol. 8542] those amounts on January 7, 1942?

A. Yes, if the conditions which I have mentioned prevail—let me change that last, please—if the conditions which prevailed when that delivery was made—will you state that question again, please?

(Whereupon, the pending question was read by the reporter.)

The Witness: That is correct, if the spare unit is available and if all the horsepower in the stations could be utilized.

Q. You would not have any hesitancy in taking on additional firm gas markets, if you could have done so?

A. Yes, I would have.

Q. You would have hesitated?

A. I would have hesitated.

Q. Because of the margin of safety that you have just mentioned? A. That is correct.

Q. And that is one compressor unit in each station?

A. In each of the three stations as of the date that Exhibit No. 79 was prepared.

Subsequent to that time two additional units have been added at the Edgerton compressing station to further insure that deliveries can be made north of Edgerton without in any way not complying with the contract re-[fol. 8543] quirements as to pressure and, particularly, with regard to the Detroit market.

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Q. When were those two units installed at the Edgerton station?

A. Construction of those two units was started June of 1941 and they were placed in service, I believe, in December of 1941.

Q. And they were in service, of course, on January 7, 1942?

A. That is correct. They were available for service on that day.

Q. Now, what you have said with respect to the figures appearing in Column C, appearing in Exhibit 79-A, "Provided daily capacity to deliver firm gas-M.e.f.", applies with equal force to Columns D, E, G, I and K in Exhibit No. 79. Is that correct?

A. It does not. We did not consider it necessary to [fol. 8544] provide spare capacity at the compressing station until the summer of 1940.

Q. Well, what about your heading and figures shown under the heading "Provided Daily Capacity to Deliver

Firm Gas, M.c.f." in Exhibit 79? Is that a correct characterization of the figures you there show?

A. That is a correct characterization. That capacity to deliver firm gas was provided but no additional or no spare capacity was provided in those years to take care of the outage of compressors or to take care of this non-uniform hourly rate of delivery to Detroit.

Q. What I would like to know is this, Mr. Young: In Exhibit 79, you show that on December 7, 1936, your so-called "Provided Capacity to Deliver Firm Gas" was 70,600 M.c.f.'s whereas you did, in fact, deliver, as shown in Exhibit 79-B, Column C, on that day, 71,663 M.c.f.'s. It is apparent that you could have delivered more firm gas than that which you did deliver on that day, is that right?

A. Yes, but the slight difference there might have been taken out of pack. The point I wish to make is, Mr. Littman, that prior to the summer of 1940, we did not consider it necessary to provide any spare capacity in these compressor stations.

Q. Let's look at the maximum day of December 27, 1938. Column G of Exhibit 79 shows, "Provided Daily [fol. 8545] Capacity to Deliver Firm Gas" in Column G of 109,000 M.c.f.'s whereas you did deliver 113,347 M.c.f.'s of gas on that day; isn't that correct?

A. That is correct.

Q. You could have delivered 113,347 M.c.f.'s of firm gas if you had had the market?

A. Not for any length of time. That difference there was taken out of pack, as I recall it. We might have been able to do that for one day, maybe for part of a second, but we would not have been able to do that rather continuously.

Q. Let's look at March 18, 1941, the maximum day for the winter 1940-1941. You say you had a "Provided Daily Capacity to Deliver Firm Gas" as shown in Column K of Exhibit 79 in the amount of 159,850 M.c.f.'s whereas Exhibit 79-B shows you delivered approximately 20,000 more M.c.f.'s on that day. A. Yes.

Q. All that did not come from the line pack, did it?

A. No, we had this spare equipment installed at that time. It had been installed in the summer of 1940.

Q. But prior to that time you did not have the spare equipment? A. That is correct.

Q. Now, the difference between the amount of "Provided Daily Capacity to Deliver Firm Gas" and the [fol. 8546] "Maximum Daily Delivery of Firm Gas" throughout Exhibits 79, 79-A and 79-B represents the interruptible industrial gas, does it not?

A. That is correct.

Q. You were going to furnish for the record the amount of rate case expense paid to December 31, 1941, and which had been reported on the books of the company?

A. The expenses incurred in connection with the current proceedings before the Federal Power Commission total \$39,801.13 as of December 31, 1941.

Mr. Baldridge: May I ask just one question, Mr. Littman.

That, I take it, does not include such amounts as may have been accrued up to that date but not paid, does it? I have in mind possible bills for services which were rendered prior to that date although the bills may not have been presented to you or paid at that date.

The Witness: That does not include the full amount of our obligations as of that date, Mr. Baldridge.

By Mr. Littman:

[fol. 8548] If it is a brief examination—

Mr. Chamberlain: (Interposing) I think five minutes would do it and we might as well get it out of the way.

I would like to have this document marked for identification as Exhibit 167.

(Exhibit No. 167 was marked for identification.)

Cross-Examination (Continued)

Q. Mr. Young, I have handed you a document marked Exhibit No. 167 for identification which shows the number of the check, the date and the amount of each of the payments made by Michigan Consolidated Gas Company for gas purchased through Michigan Gas Transmission Corporation for its use in the Detroit district from August 1936 to December 20, 1941. I have heretofore shown

you that exhibit and ask you to check to see at what time funds were received by Michigan Gas Transmission Corporation and deposited to their account.

This exhibit shows the date of the cancelation of each of these checks and I would like to ask you as to whether, with the exception of some nine checks which you can hereafter identify, those checks were deposited by Michigan Gas Transmission Corporation on the dates which show the date of the cancelation of the check?

A. Except in the case of the nine checks which you have referred to, my information is that all of the checks [fol. 8549] on Exhibit 167 for identification were deposited on the same date that they are indicated as having been canceled.

Q. Will you state the nine exceptions and give the number of the check and the date upon which it was actually deposited?

A. Check No. 37720—

Q. (Interposing) I am going to have to change my question a little bit because those numbers do not run always consecutively. I will require the number of the check and the date of the check.

A. I see.

Q. Or the amount, that would do it.

A. I have the amounts here.

Q. Yes, the amount will do it.

A. Check No. 37720 in the amount of \$110,641.17 was deposited on October 21, 1936.

Check No. 41286 in the amount of \$307,881.32, was deposited on January 21, 1937.

Check No. 284, in the amount of \$100,000, was deposited January 21, 1937.

Check No. 2384, in the amount of \$150,000, was deposited January 21, 1938.

Check No. 52847, in the amount of \$346,002.84, was deposited January 21, 1938.

Check No. 2506, in the amount of \$150,000, was deposited [fol. 8550] February 21, 1938.

Check No. 53458, in the amount of \$372,993.27, was deposited February 21, 1938.

Check No. 1383, in the amount of \$353,553.71, was deposited on November 22, 1938.

Check No. 1140, in the amount of \$85,000, was deposited November 22, 1938.

Q. I would like to clear up an apparent discrepancy in these dates. It is a fact, is it not, that three of the nine that you have mentioned were deposited upon the day that the check shows canceled but the reason they were included was because they were deposited with another check on the same day which was deposited one day before the cancellation date?

A. Yes, three of the nine checks which have just been mentioned were canceled on the same date on which they were deposited and they were included in this list because they were deposited with the other six.

Mr. Chamberlain: That is all.

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[fol. 8554] Mr. Littman: If your Honor please, before proceeding with the cross-examination this morning, I would like to have inserted into the record at this point a copy of an order issued by the Securities and Exchange Commission on February 3, 1942, which shows precisely the bid price from a group of underwriters headed by Gore, Forgan & Co. and Kidder, Peabody & Co., with respect to the recent financing of Panhandle Eastern Pipe Line Company. It is a very brief order and I believe it would be helpful to have this order in the record in its entirety.

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Trial Examiner: Very well, it may be copied in the record, at this point.

For Immediate Release Tuesday, February 3, 1942.

Securities and Exchange Commission Washington
Holding Company Act Release No. 3311

United States of America

Before the Securities and Exchange Commission

At a regular session of the Securities and Exchange Commission, held at its office in the City of Washington, D. C., on the 3rd day of February, A. D., 1942.

[fol. 8555] Supplemental Order Pursuant to Rule U-50.

In the Matter of

Columbia Gas & Electric Corporation, Columbia Oil & Gasoline Corporation, Panhandle Eastern Pipe Line Company, Michigan Gas Transmission Corporation, Indiana Gas Distribution Corporation, the Ohio Fuel Gas Company.

File Nos. 59-33, 70-263, 70-371, 70-387,
70-430, 70-431

(Public Utility Holding Company Act of 1935)

Panhandle Eastern Pipe Line Company, a subsidiary of Columbia Gas & Electric Corporation, a registered holding company, having filed an application pursuant to the Public Utility Holding Company Act of 1935, particularly Section 6 (b) thereof and Rule U-50 thereunder, regarding the issue and sale of \$10,000,000 principal amount of 3% First Mortgage Bonds and [and] \$15,000,000 par value of Cumulative Preferred stock, the proceeds to be applied toward the retirement of \$10,000,000 par value outstanding Class A \$6 participating Preferred stock, the acquisition of certain wholly-owned subsidiaries of Columbia Gas & Electric Corporation, and additional construction; Panhandle Eastern Pipe Line Company to publicly invite proposals for the purchase of the bonds and preferred stock in accordance with Rule U-50; and

Said application having been consolidated in the above-entitled consolidated proceeding, and the Commission hav-

[fol. 8556] ing, on January 21, 1942, granted such application pursuant to Section 6 (b) subject to the conditions, among others, that applicant report to the Commission the result of the competitive bidding as required by Rule U-50 (c) and comply with such supplemental order as the Commission may enter in view of the facts disclosed thereby, jurisdiction having been reserved for this purpose; and

Panhandle Eastern Pipe Line Company having made such report to the Commission in the form of an amendment to the application herein, setting forth the action taken to comply with Rule U-50 (c) and specifying the proposals which have been received for the purchase of said bonds pursuant to the invitation for competitive bidding, and setting forth that Panhandle Eastern Pipe Line Company has accepted a bid from a group of underwriters headed by Gore, Forgan & Co. and Kidder, Peabody & Co., of 100.02% for the bonds which are to be resold to the public at 100.75%, representing a spread to the underwriters of .73%, and 100.2789% for cumulative preferred stock having a dividend rate of 5.6%, which stock is to be resold to the public at 104%, representing a spread to the underwriters of 3.7211%, of which 2.25% represents the spread to dealers; and

The Commission having examined the record and finding no basis for imposing terms and conditions with respect to the issue and sale of said bonds and preferred stock at such price and with such spread;

[fol. 8557] It is ordered that said application, as amended, be and it is hereby granted in regard to the price to the issuer, the spread, and the distribution thereof applicable to such bonds and preferred stock, subject, however, to the terms and conditions prescribed in Rule U-24.

By the Commission

(Seal)

FRANCIS P. BRASSOR,

Secretary.

Mr. Littman: I would like to have marked for identification as Exhibit No. 168 a tabulation which has been furnished by Mr. Haberly pursuant to my request, entitled

"Michigan Gas Transmission Corporation-Tabulation of Measuring and Regulating Stations showing Stations Which were Inspected by Francis S. Haberly and Those Which Were Not Inspected."

(Exhibit No. 168 was marked for identification.)

"Mr. Littman: I would like to ask that this exhibit be received in evidence at this time."

Trial Examiner: The tabulation marked for identification as Exhibit No. 168 will be received in evidence without objection.

(Exhibit No. 168 was received in evidence.)

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[fol. 8558] DANIEL C. GREEN, a witness, having been previously duly sworn, resumed the stand and testified [fol. 8559] further as follows:

Cross Examination

By Mr. Littman:

Q: Mr. Green, you are an engineer?

A: Yes, sir.

Q: You are President and Director of Central Service Corporation, a corporation which specializes in rendering consulting, advisory and special services to public utility companies?

A: Yes, sir.

Q: Your firm has been retained for the purpose of presenting certain exhibits in this proceeding relating to Michigan Gas Transmission Corporation?

A: That is correct.

Q: Your firm is retained by Columbia Gas & Electric Corporation?

A: By Michigan Gas Transmission Corporation.

Q: Who retained you?

A: The President of that company.

Q: You refer to Mr.—

A: (Interposing) Beckjord.

Q: Mr. Beckjord is an officer of Columbia Gas & Electric Corporation, is he not?

A: I think he is, yes.

Q. He is Vice-President, is he not, of Columbia Gas & [fol. 8560] Electric Corporation?

A. I am not certain of that. Whether he is an officer of Columbia Gas, or whether he is an officer of their service company, I do not know.

Q. I read from pages 2018 and 2019 of the transcript where Mr. Beckjord testified as follows:

"In 1938 I became President of Columbia Engineering Corporation, still continuing as Vice-President and General Manager of the Columbia Gas & Electric Corporation."

Q. A. Yes.

Q. Does that refresh your recollection?

A. Yes. On second thought, I believe he is Vice-President and a Director.

Q. He says, "Vice-President and General Manager."

A. Yes.

Q. Will you please refer to Exhibit No. 92, entitled "Michigan Gas Transmission Corporation-Original Cost Depreciated to Present Conditions as of June 30, 1941, and Observed Depreciation as at June 30, 1941"? This exhibit shows, does it not, that you have deducted from the original cost new of the plant of Michigan Gas the sum of \$310,226.50 which represents the "Observed depreciation"?

A. Yes, sir, that is correct.

Q. Now, this amount of "Observed depreciation" was determined in the first instance, percentage-wise, by Messrs. Riddle, Lehn and Haberly. Is that correct?

[fol. 8561] A. Correct.

Q. You are taking responsibility for this exhibit, are you, Mr. Green?

A. Yes, sir. That is, I directed its preparation.

Q. Yes, I understand that you made no determination of your own of the observed depreciation. Is that right?

A. That is correct.

Q. But this exhibit is your idea?

A. Yes, sir.

Q. Does the sum of \$310,226.50 represent all of the depreciation that has accrued to date on the original cost of the property of Michigan Gas Transmission Corporation?

Mr. Baldridge: By "to date" you mean as of the time of the preparation of the exhibits?

Mr. Littman: I mean as of June 30, 1941.

The Witness: The amount of \$310,226.50 deducted from the original cost figure of \$12,261,260.55 expresses the value of the physical property as of June 30, 1941.

By Mr. Littman:

Q. Now, will you please answer my question, Mr. Green?

Trial Examiner: Read the question, please.

(Whereupon, the question commencing at Line 11 of this page was read by the reporter.)

The Witness: In the opinion of these engineers that [fol. 8562] amount represents, in their judgment, the observed depreciation of the property as of June 30, 1941.

By Mr. Littman:

Q. What I would like to have, Mr. Green, is your opinion of whether this amount of \$310,226.50 represents all of the depreciation that has accrued to June 30, 1941, on the original cost of the property of Michigan Gas Transmission Corporation.

A. Where we are confused or where I am confused is your use of the term "accrued." Now, if you are referring to the books of the company and some device of accounting which the management might adopt, on a straight line method or any other method or retirement reserve method, that would be one thing, but that is not this figure, that is not what this figure purports to represent.

Q. Mr. Green; when I use the term "accrued depreciation", I mean all of the depreciation that has accrued down to June 30, 1941. Does that help you?

A. No, it does not. My answer that I first gave as to what the \$310,000 odd figure represents is as I have stated it.

Q. It merely represents that depreciation which has been observed?

A. That is correct.

Q. But not all the depreciation that has, in fact, accrued?

[fol. 8563] A. It is all the depreciation that actually has accrued or occurred up to that date,—not accrued, I think our use of the word "accrued" confuses both of us. "Ac-

erued" means more or less per books, an accounting expression, I would think.

Q. Well, did Mr. Haberly's Exhibit No. 82 confuse you?

A. 82?

Q. Which is entitled "Accrued Depreciation".

A. No, because—

Q. (Interposing) On compressor station structures and so forth.

A. No, because these amounts found by the engineers were at my direction to determine the depreciated value as against original cost as of June 30, 1941.

I will give this example which might help. We will assume that a piece of pipe has an estimated life of 75 years. If you would use straight line depreciation you would divide the total cost of that pipe by the 75 years and you would get an amount which, for convenience in accounting, you charge against earnings and set up in a reserve account each year that fixed amount.

Now, my point is that we will say ten years, that the pipe has been in the ground ten years, and the actual value of that pipe will not decrease on a straight line basis, its value will not decrease.

[fol. 8564] Q. How about its original cost as distinguished from what you have termed "value"?

A. I am referring to original cost here. When I speak of "value", "value" means original cost.

Q. Now, you just said if I would depreciate the property on a straight line method I would get the result which you just gave in your hypothetical statement.

A. That is right.

Q. What method does Michigan Gas Transmission Corporation use to depreciate the property on its books? The straight line method, isn't that correct?

A. I think they do. I would not want to say definitely that they used the straight line method.

Q. Didn't you investigate that?

A. I know the amount they are setting up is approximately 3 percent of the plant account.

Q. Mr. Green, do you mean to say you do not know for certain that Michigan Gas Transmission Corporation uses the straight line method of depreciation on its books?

A. They are setting up 3 percent of the plant account.

Q. On a straight line basis?

A. They are charging against income and earnings 3 percent of the plant account and setting it up in reserve.

Q. Which is the straight line method, isn't it?

A. No. A company might be charging 3 percent of its [fol. 8565] plant account and be on the retirement reserve method but, during the early years of the life of the property, they determined 3 percent would be ample, whereas, against the straight line method, the actual depreciation might be 4 percent.

Q. What method does the company use?

A. I do not know. I can tell you what they have done but whether they are accruing on a straight line method of depreciation, I do not know.

Q. I take it from your answer you have set up in your exhibit a different method than that followed by the company in depreciating its property?

A. Yes, sir, we did.

Q. Let me refer you to Page 3 of Exhibit No. 99 which shows "Depreciation Provision per Books for Years Ended December 31, 1936, to 1940, Inclusive and Six Months Ended June 30, 1941," and ask you whether your examination of that page will refresh your recollection as to the method used by the company in setting up depreciation on its books?

A. I cannot change my original statement.

Q. You are at liberty to do so if you want to.

A. I do not.

Q. You do not want to?

A. I do not, no.

Let me say that suppose it is exactly 3 percent of their plant account each year that has been charged. That is not [fol. 8566] proof that they are using the straight line method. In the straight line method of depreciation, you determine the life of the property and divide the number of years by the original cost or value that you are depreciating. That is the straight line method and you set that amount up each year. Now, this company has been charging approximately 3 percent.

Mr. Lee: Wasn't that predicated upon the estimated life of the field?

The Witness: I do not know how they determined the 3 percent but I know the company could set up 3 percent in the early years and later set up 5, an average of 4 percent, if 4 is the proper amount based upon the life of the property. Of course, here, we have a property with a finite life which raises an entirely different question of depreciation and amortization because the life of the property is based on its usefulness and not on the number of years that it will stay in service.

Mr. Lee: Weren't you bound to consider that? Wasn't that the underlying consideration?

The Witness: Yes, we used in our Exhibit 24½ years as the finite life of this property from June 30, 1941.

By Mr. Littman:

Q. Having defined the straight line method, do you see anything on Page 3 of Exhibit 99 which would indicate that the company is not using the straight line method?

A. There is nothing here that would indicate to me on [fol. 8567] what basis they determined the depreciation that they have charged. I see nothing on this page that gives the method of determining the amount they have set up.

Q. If the company had been using a straight line method, for all that appears on Page 3 of Exhibit No. 99, that method could be used? In other words, there isn't anything on Page 3 of Exhibit No. 99 that indicates that the company is using other than a straight line method, is there?

A. There is nothing on that page that indicates that they are using a straight line method either.

Q. They have been setting aside 3 percent each year, have they not, since the beginning?

A. Yes, sir, approximately, so.

Q. They have not changed that percentage at all in any year thus far, have they?

A. I think that is correct. They have been setting aside that amount.

Q. Wouldn't you do that by the straight line method?

A. If they are using the straight line method and they set up 3 percent of the property each year, that means the property has a life of 33½ years.

Q. That is what Page 3 of Exhibit No. 99 indicates to you, doesn't it?

A. No, it does not.

Q. Have you investigated whether the company pro-[fol. 8568] poses to change this depreciation rate of 3 per cent?

A. No, I do not know.

Q. You did not investigate it?

A. No.

Mr. Baldridge: Mr. Littman, just to be sure you aren't confused, may the record show that 3 percent does not apply to all the property but to most of it. There are certain types of property which, as I recall, consist of non-depreciable property on the one hand and short-lived property on the other, which is depreciated somewhat differently. I assume that you are talking about the great bulk of the property, to which 3 percent was applied.

By Mr. Littman:

Q. At any rate, you have undertaken, for purposes of this proceeding, to set up a new and different method of depreciating this property than that which has been followed by the company to date, is that right?

The Witness: Would you read that, please?

(Whereupon, the pending question was read by the reporter.)

The Witness: That is correct.

By Mr. Littman:

Q. What is wrong with the company's method that requires you to now change the scheme of things?

A. If this property has a life of $24\frac{1}{2}$ years from June 30, 1941, 3 percent of depreciable property set up per year [fol. 8569] will not amortize the investment over that expected life of $24\frac{1}{2}$ years so, if we would use operating expenses and the depreciation that could be charged per books as an item of expense and amortized on that basis, the company would be short in recouping its investment at the end of $24\frac{1}{2}$ years.

Q. You propose, then, to substitute your judgment for the judgment of the company with respect to the life of the property, do you not?

A. Not at all and that is my point. The fact that they are charging 3 percent at the present time in the comparatively early years of the life of this property is no indication whatsoever in later years they might not charge 5 percent. As time goes along and they learn more about the life of this field, it might be found that it is a 20-year life or 40-year life, I do not know.

Q. Has any officer of the company indicated that they were going to change their depreciation rate policies?

A. In our opinion, it was not necessary to use those figures from the company's books in preparing the data which we thought would be useful to the Commission in determining the necessary revenues of this company.

Q. I am not speaking of what was necessary. What was proper? Would it have been proper to use the company's own depreciation rates and methods for purposes of this proceeding?

[fol. 8570] A. It would not. I will answer your question this way: Suppose this company had been setting up 6 percent in depreciation in order to cut down their earnings. They set up 6 percent. I think it would be manifestly unfair, in preparing the exhibits which we have here, if we were to use that 6 percent as a fair amount for depreciation.

Q. Of course, they have not set up anything like 6 percent, have they?

A. I said, if they had.

Q. I take it that you are saying, then, that you disagree with the depreciation policy followed by the company thus far?

A. I will say this, that if I were President of Michigan Gas Transmission Corporation or if I were a large stockholder in that corporation, I would want the company to increase its depreciation charges that they show per books and I would have them increase it so that we would recoup the investment in 24½ years.

Q. You are acquainted with Mr. Young, the Vice-President of this company, are you not?

A. Yes, sir.

Q. You know that he has testified in these proceedings that he is satisfied that the rates presently charged are reasonable, proper and adequate?

A. I do not know. I did not see that.

[fol. 8571]. By Mr. Littman:

Q. What amount has been accumulated in this depreciation reserves at June 30, 1941? You will find that in Exhibit 88, Page 2, Mr. Green.

A. \$1,526,600.89.

Q. Now, according to your testimony, the probabilities are that that sum is not sufficient to cover the depreciation that has accrued on the property to date isn't that right?

A. No. In the exhibits which we have prepared here, the accounting method of the company and its practices and policies on the question of depreciation have no bearing whatsoever, in my opinion, on the amount that the Commission should set up here for depreciation.

Q. Didn't you just say a minute ago, Mr. Green, that if 24½ years represent the true remaining life of this property and you do believe just that, then the 3 percent rate which has been set by the company is too low. Hasn't that been your testimony thus far?

A. Correct, yes.

[fol. 8572] Q. All right. Now, if the 3 percent is too low, then this amount that has been accumulated in the depreciation reserve at June 30, 1941, of \$1,526,600 is also too low according to your testimony, isn't that correct?

A. No, we are speaking here of amortizing the investment. That is the problem we had before us, to determine how much per year should be charged against income so that the investor will recoup his investment at the end of the 24½ year expected life of the property. What the company charged on its books for depreciation, what it accrued, in my opinion has no bearing whatsoever.

Q. Now, will you answer my question, please.

Mr. Littman: Will you read my question?

(Whereupon, the question commencing at Line 1 of this page was read by the reporter.)

The Witness: If the company had charged earnings and set up in reserve an amount in excess of 3 percent, this amount in this reserve would be greater to that extent.

By Mr. Littman:

Q. I am not asking you to assume any hypothetical state of facts. I am asking you to answer my specific question, Mr. Green.

A. I think I made the statement a little while ago if I were President of this company, I would be setting up on the books an amount for depreciation in excess of what [fol. 8573] this company has.

Q. And if you had been President of this company, you would have accumulated a larger amount than \$1,526,600 in your reserve down to June 30, 1941, would you not?

A. If the company had charged more, there would be more in the reserve.

Q. Then your answer to my question is yes?

A. If they had charged more, the amount in the reserve would have been greater.

Q. Will you answer my question yes or no?

A. I think I have answered the question.

Q. The answer is yes?

A. You will have to read the question.

Q. Didn't you have my question in mind at the time when you were giving your answer, Mr. Green?

Mr. Littman: Read the question, please.

(Whereupon, the question was read as follows:

"Q. All right. Now, if the 3 percent is too low, then this amount that has been accumulated in the depreciation reserve at June 30, 1941, of \$1,526,600 is also too low according to your testimony, isn't that correct?")

The Witness: If the company had charged a percent greater than the percent used each year and all charges, credits and debits against this reserve account had been exactly the same as they have actually been, this amount would be greater to that extent.

[fol. 8574] Q. And, in your opinion, should be greater?

A. Indeed so, yes, per books, and having nothing to do with this other question.

Q. You want to forget about the books when you come into this rate proceeding and determine depreciation, do you?

A. Absolutely, absolutely.

Q. Well, we don't, Mr. Green. Let's talk about the book depreciation for the moment. It is clear that Michigan

Gas has accumulated \$1,526,600 to June 30, 1941. There is no question about that, is there?

A. That is the amount in the reserve account.

Q. And you say that, if anything, that is too low, not enough?

A. I say that I would amortize the investment over a shorter period than they apparently are, from this present amount being charged.

Q. And that would give a greater balance in the reserve if that had been done from the beginning?

A. That is correct, naturally it would. That is pure arithmetic.

Mr. Baldridge: That is assuming the straight line method?

The Witness: Yes, sir.

By Mr. Littman:

Q. Which the company has been doing?

[fol. 8575] A. As I testified in my direct testimony, to me there is no difference whether you use the straight line method or the sinking fund method.

Q. You get the same result, according to your testimony?

A. With proper application of all the principles, you will come out with the same answer.

Q. All right. In place of the \$1,526,600 of depreciation which has been set up on the books of the company as represented by the balance in its depreciation reserves at June 30, 1941, you propose to deduct \$310,226.50, do you not?

Trial Examiner: Will you read the question, please?

(Whereupon, the pending question was read by the reporter.)

The Witness: What we are attempting to do in this exhibit is to determine the value of this property as of June 30, 1941, its dollar value. I contend that the value does not follow the straight line method.

By Mr. Littman:

Q. All right. Now, are you saying that the amount of \$11,951,034.05, which is the total of the column headed

"Original Cost Depreciated to Present Condition", represents the value of this property at June 30, 1941?

A. You had better read that to me.

(Whereupon, the pending question was read by the reporter.)

The Witness: Correct.

[fol. 8576]. By Mr. Littman:

Q. Now, in arriving at this so-called "value" you have deducted the observed depreciation of \$310,226 rather than the actual book depreciation of \$1,526,600. Is that right?

A. Yes.

Q. Now, you are familiar with the fact that the Panhandle Eastern Pipe Line Company recently, as a matter of fact during the past three weeks, acquired Michigan Gas?

A. Yes, sir.

Q. In arriving at this purchase price, did they deduct your \$310,226 of "Observed Depreciation" or did they deduct the book reserves of \$1,526,600? Can you answer that directly, first, and then explain it, if you wish?

A. I do not know what method was used in their negotiations of that sale and purchase.

Q. Well, you know, do you not, that Panhandle Eastern Pipe Line Company paid Columbia Gas & Electric Corporation for Michigan Gas on the basis of the net investment?

A. I understand so, generally, yes.

Q. And the method of arriving at that price, which was the net investment, was by deducting the actual book depreciation from the gross investment?

A. I think the method used in this purchase and sale was a shotgun method, myself.

Q. Now, will you answer my question, please, and then [fol. 8577] we will talk about the shotgun marriage? Suppose you answer my question first. I want to, first, know whether that is the way they arrived at it?

A. You mean the calculation that was made to determine the purchase price of the property which Panhandle—

Q. (Interposing) Well, first, is it your understanding, as it is mine, that Panhandle Eastern paid for Michigan Gas on the basis of the net investment in the property?

A. I think that is correct, that is my understanding.

Q. And the net investment was arrived at by deducting the full depreciation reserve of the gross investment, is not that right?

A. Well, you naturally would.

Q. If there is any question about it, I want to clear that up.

A. That is correct.

Q. Now, you are intimating that Panhandle Eastern Pipe Line Company did not pay the value of the property to Columbia Gas & Electric Corporation?

A. In my opinion, the value of Michigan Gas Transmission would be in excess of the amount that the Panhandle Eastern company paid for it.

Q. Not in the opinion, however, of Panhandle Eastern?

A. Why, it means that they made a good buy, Panhandle Eastern. If they agree with what I am saying, they [fol. 8578] made a good buy.

Q. And according to your testimony, Michigan Gas Transmission Corporation did not make a good sale?

Mr. Cullon: You mean Columbia?

Mr. Littman: All right, Columbia Gas & Electric Corporation did not make a good sale?

The Witness: From their own standpoint, probably, it was a good sale for them to make, under the conditions and unusual problems confronting them.

By Mr. Littman:

Q. They were satisfied, were they not, to accept this amount of money that was paid by Panhandle Eastern Pipe Line Company for Michigan Gas?

A. Why, I do not imagine that they would have closed the deal if they were not satisfied with it.

Q. Everybody seemed satisfied with it but you, Mr. Green. Now, I would like to have you tell me what causes you to be dissatisfied with the arrangement that was entered into between Columbia Gas and Panhandle Eastern.

A. Let me make this statement, it will be very broad, probably, you might think. I think that with most any

utility company, its sale value exceeds its net investment per books.

Q. Did Columbia Gas—

A. (Interposing) I will put it this way: I do not think you could go out and buy one out of 50 utilities, that is, [fol. 8579] if they are well managed, and earning on the rate base a fair return, on the proper base. I do not think you could buy the property in normal times for its net investment per books. I think they usually sell in excess of that amount.

[fol. 8580] By Mr. Littman:

Q. Well, you just spoke about a shotgun marriage of some kind. Now, what was forced about this thing, this sale?

A. My thought was this, I do not believe that Columbia Gas & Electric Corporation would voluntarily sell this property, but on account of the Securities and Exchange Commission's rulings under the Holding Company Act they have to sell it and they were told that they had to dispose of it.

Q. They did not have to sell it to Panhandle Eastern at this price, did they? They could have sold it to somebody else at a higher price if they could have got a higher price?

A. From what Mr. Lee said, apparently, there was some commitment.

Mr. Lee: I was asking you if there was something of that kind that you knew about.

The Witness: I am not familiar with the law suits that are pending against Columbia Gas and Columbia Oil and Panhandle and Missouri-Kansas.

By Mr. Littman:

Q. But you have characterized this arrangement as a shotgun marriage. Now, I want you to point out what characteristic of this sale causes you to describe it in that way.

[fol. 8581] A. Well, the S. E. C., it is my understanding, has, perhaps, ordered, —I think they have ordered Columbia to dispose of this property and others under the Integration Act.

Now, how could they sell this property to anyone other than Panhandle, because you have a pipe line here stuck out in the Indiana-Illinois line hundreds of miles away from a natural gas field and the company with a contract only running 16 years longer for a supply of gas?

Mr. Baldridge: And the main contract is substantially less than that.

The Witness: Substantially less than 16 years, yes.

By Mr. Littman:

Q. Do you know whether Columbia Gas & Electric Corporation made any effort to sell to anyone else?

A. Not that I know of.

Q. Do you think they were negligent in selling Michigan Gas to Panhandle Eastern at the net investment?

A. No, their reasoning, I do not know what their reasoning was.

Q. The Securities and Exchange Commission approved this sale, did it not?

A. Yes, sir.

Q. Do you think the Securities and Exchange Commission would approve this sale if it felt that the owners of Michigan Gas were not receiving a fair price for Michigan Gas?

[fol. 8582] A. Well, under the Act if they approved a sale they have to approve the value amount.

Q. And they found the value to be proper, just and reasonable?

A. Proper and reasonable in their opinion.

Q. But not in your opinion?

A. That is correct.

Q. Do you think Columbia Gas could have got even more for Michigan Gas than it did?

A. I do not know.

Q. Do you know whether Columbia Gas & Electric Corporation appealed from the Securities and Exchange Commission's decision of approval of this sale?

A. Well not, to the contrary they must have approved it in the hearings.

Q. All of which indicates that they were satisfied, does it not?

A. Certainly.

Mr. Culton: Whether contented or not.

By Mr. Littman:

Q. Regardless of what your opinion is as to the fairness of this price, Mr. Green, are not the consumers entitled now to derive any benefits that may flow from Panhandle Eastern's good fortune in purchasing Michigan Gas?

A. I do not think that that is the determining factor, [fol. 8583] this sale price. For example, suppose that Panhandle Eastern paid 50 percent greater in amount than they did pay for this property. I do not think that that would be the yardstick or the rate base under which rates would be fixed.

Q. Will you please answer my question, Mr. Green, whether it is determinative or not?

A. I say that rates are not based on the sale or purchase price of properties.

Q. They should not be based upon that?

A. Certainly not, they should not. It would be very much against the interest of the consumers all over this country if that would be held to be the method of rate making, to use the purchase price as the rate base, because I know of many properties that were purchased far in excess of a proper rate base.

Q. Do you think Panhandle Eastern Pipe Line Company is entitled to earn a return on something in excess of the price which it paid for Michigan Gas Transmission Corporation?

A. If you use original cost as the rate base, I think you have to take into account other factors in determining the percent return that the stockholders should receive.

Q. Can you answer my question yes or no, Mr. Green?

A. I cannot answer by saying yes or no, it would be misleading.

Q. There is some doubt in your mind about the question, is there?

[fol. 8584] A. I am not in doubt about my own opinion in this matter.

Q. What I am speaking is your opinion, Mr. Green.

A. I am saying that I do not think that rates should be based on the purchase price of properties.

Q. Even though the purchase price represents the actual cost less the depreciation reserve?

A. I do not think that is the point, no.

Q. That would not make any difference to you?

A. No.

Q. And even though Panhandle Eastern Pipe Line Company paid on the basis of original investment less depreciation reserves, in your opinion, they are entitled to something in excess of that?

A. No, I am saying this, you take that figure then and on the other side of the equation in determining the percent return then you have some other factors to consider which we have considered and have put into these exhibits.

Q. All of which results in giving Panhandle Eastern a larger rate base?

A. Not a larger rate base, no, because in our exhibits here we are using original cost of Michigan Gas Transmission Corporation.

Q. Mr. Green, you give considerable lip service to original cost. You are not using original cost at all, are [fol. 585] you, in your exhibits?

A. Absolutely we do, sir.

Q. I see. Well, we will come to that a little later, Mr. Green, and we will see what the effect is after you get through using it, but right now do you deny that after you get through with your arithmetic you come out to precisely the same result as though you had used reproduction cost?

A. That is correct, but that does not make our method or answer wrong.

Q. But you come out at the same place precisely as though you had used reproduction cost. Is that correct?

A. That is pure arithmetic. You can make the two calculations and they will be the same.

Q. Is that correct? Is your answer to my question yes?

A. I say the two answers would be exactly the same but a different method of calculation.

Q. Do you think it would be any comfort to the gas consumer that you started out with original cost if, in the final analysis, his rates are the same as though you had used reproduction cost?

A. Well, as I said in my direct testimony, there is no difference between the two. You can use reproduction

cost or you can use original cost if you properly define what is a fair rate of return.

Q. And as you define it, you get exactly the same result [fol. 8586] [regardness] of which you use?

A. You mean the over-all amount that the company should receive in dollars figures out arithmetically the same. Correct.

Q. Almost to the penny, as a matter of fact, does it not?

A. If you use the same factors, yes, sir. Two times six is twelve and three times four is twelve.

Mr. Baldridge: Mr. Littman, what I was going to suggest was that I think you used the wrong word there. You may not have. I thought you used "original cost" at one point where you meant [so] say "reproduction cost." I may be wrong, I think the record will show.

—Mr. Littman: I think the record will show that we understand each other on this point.

By Mr. Littman:

Q. Let's examine Exhibit No. 92, again. Now, you have an item under "Transmission Plant" called "Land Rights" which has an original cost of \$241,467.33. Is that right?

A. That is right.

Q. Now, that is what those land rights cost when first acquired, now. Right?

A. Yes, sir.

Q. Those are rights-of-way, are they not?

A. Yes, sir.

Q. For the main transmission lines and other lines?

[fol. 8587] A. Yes, sir.

Q. Now, at least five years have elapsed since they were acquired. Is that right?

A. Yes, about.

Q. Probably having been constructed in about 1936. How much do you deduct for depreciation on those rights-of-way?

A. There is no deduction made here by the engineers in this calculation. There is no deduction made.

Q. The company has been making some deduction on their books for depreciation on rights-of-way, have they not?

A. The over-all depreciation they have been setting up would be against all amounts in the capital account and this is in the capital account.

Q. At the 3 percent rate which the company has been applying to its lines the annual amount being set aside will amount to \$7,244 per year or approximately \$40,000 over the 5½ years of the expired-life of the company. Is that about right?

A. That is correct. I do not know whether the company, though, in their calculations of percent,—sometimes in the plant account land is not considered a depreciable item, you see.

Q. Well, this is not land, this is land rights-of-way.

A. Yes, but I say I do not know whether they do use that or not.

Mr. Littman: Mr. Spitznagle may be able to advise us [fol. 8588] as to that.

Mr. Spitznagle, does the company depreciate its rights-of-way on its books?

Mr. Spitznagle: I am trying to check it, Mr. Littman, and see whether or not they included the figure in the computation.

Mr. Chamberlain: Refer to Page 76 of the new prospectus there and you will find that that is excluded.

Trial Examiner: Perhaps you should identify what you refer to as the "new prospectus."

Mr. Chamberlain: It is the prospectus for \$10,000,000 of first mortgage bonds.

Trial Examiner: Can't you give the exhibit number?

Mr. Chamberlain: I do not know the exhibit number.

It is Exhibit 146. That refers, however, only to land; I do not know that it includes land rights.

It says, "It is the policy of the company to provide the reserve for the retirement of property by the accrual of an annual provision equal to 3 percent of the balance in the property account at the beginning of the year (exclusive of land and contributed property, and exclusive of

automobiles and special tools which are depreciated over their estimated useful lives)." .

Mr. Baldrige: That is what I was pointing out earlier, Mr. Littman, when I said the 3 percent was not applicable [fol. 8589] to everything, but to the great bulk of property.

By Mr. Littman:

Q. Mr. Green, the statement which has just been read into the record by Mr. Chamberlain indicates that the company depreciates its rights-of-way, isn't that correct?

A. I would infer so from this statement, yes.

Q. But you do not?

A. What is that?

Q. You do not?

A. The engineers did not depreciate that amount.

Q. In setting up your annual allowances for depreciation in Exhibit No. 104, do you depreciate those rights-of-way?

Mr. Baldrige: Aren't you confusing two things there, Mr. Littman? Aren't you confusing depreciation and amortization?

Mr. Littman: I am not the least bit confused.

By Mr. Littman:

Q. Are you confused, Mr. Green? Do you have difficulty in understanding me?

A. In Exhibit 104, there is reflected a calculation which shows we amortized the full original cost of land rights over the period of 24½ years.

Q. You recognize that these rights-of-way do, in fact, depreciate after June 30, 1941, do you not?

A. That was not the purpose of our calculation. Our [fol. 8590] calculation was to amortize the expense of land rights over the 24½ year life.

Q. Have you deducted anything in Exhibit 92 for amortization by reason of the claimed exhaustion of the gas supply?

A. Michigan Gas Transmission Corporation owns no producing wells. I do not get your question.

Q. Have you made any deduction from original cost in Exhibit No. 92 for any amount which represents the accrued amortization to June 30, 1941?

A. Per books?

Q. Yes.

A. No.

Q. Well, for anything else, have you?

A. They are two entirely different items.

Q. You can tell me whether you did or did not, Mr. Green.

A. What we were determining in Exhibit No. 92 was the value of this property at the date that regulation began which, in this case, is June 30, 1941, and what happened in prior years when there was no regulation, what the company charged on its books for depreciation, I do not think is applicable here.

Q. Well now, you have set up in your provisions for annual allowances for depreciation, an amount with which to reimburse the investors by reason for the claimed exhaustion of the gas supply over the remaining purported 24½ year life of the Transmission Corporation?

[fol. 8591] A. As applied to the long-term investment.

Q. That is practically all of it, isn't it?

A. Percentage wise, yes. The long-term investment is a very large percentage of the total, correct.

Q. 93.97, if not even more?

A. I should say in this property, pipe and compressor stations would represent 85 percent, maybe more, of the total plant account and the life of both of those items would be far in excess of the 24½ year period that we are using here.

Q. Now, when you go about setting up annual allowances for depreciation, you make those allowances sufficiently large to cover the amortization of the property by reason of the claimed exhaustion of the gas supply, do you not?

A. Yes, when you are amortizing the investment here over a fixed period. Depreciation, as generally used, refers to the life of the property continuing in business, if you are in a business that has an infinite life. Here, we have a business that has a finite life so it is really amortization of the investment rather than depreciation. I think we both would be clearer in our discussions if we used that definition.

Q. I am going to ask you a question and I would like to have you answer this question yes or no, Mr. Green, be-

cause I am fearful that this record is going to be utterly confused unless I have some direct answers to some of these questions.

I read from the Uniform System of Accounts prescribed [fol. 8592] for natural gas companies by the Federal Power Commission.

"Among the causes to be given consideration are wear and tear, decay, action of the elements, inadequacy, obsolescence, changes in the art, changes in demand and requirements of public authorities and, in the case of natural gas companies, the exhaustion of natural resources."

That statement appears on Page 4. In Exhibit No. 92, have you deducted anything whatever for that element of depreciation which is described in this Uniform System of Accounts as the "exhaustion of natural resources"?

A. I do not know how to answer that question with yes or no. This is not a depreciation—

Q. (Interposing) I do not know how we can even discuss this subject then. Don't you know what Exhibit 92 purports to represent?

A. I do.

Q. Have you or have you not made any deduction from original cost in Exhibit 92 for the element of depreciation which is described by the Federal Power Commission in its Uniform System of Accounts as "the exhaustion of natural resources". You either did or you did not.

A. I cannot answer the question the way you express it, Mr. Litman. I am sorry, but I cannot.

Q. All right, you say you cannot answer my question. Will you tell me why you cannot answer my question? In [fol. 8593] the first place, don't you understand it?

A. No, I am not quite clear just what you are referring to because you are trying to read something in this statement which is not in the statement. The purpose of this exhibit No. 92 is to determine the value of this property based on its original cost as of June 30, 1941. That is the purpose of this exhibit, to determine its dollar value.

Q. Mr. Green, if this property were to be abandoned tomorrow by reason of the claimed exhaustion of the gas supply, would it be worth as much as the original cost less depreciation which you show on Exhibit 92?

A. It certainly would not.

Q. Have you deducted anything from original cost by reason of that element of depreciation?

A. We begin with this figure of \$11,951,000. We used that. That is the value as of June 30, 1941. We begin from there in our later exhibits and amortize that over 24½ years.

Q. Will you answer my question, please? Have you deducted anything from original cost in Exhibit No. 92 which would reflect the element of depreciation described in the Uniform System of Accounts as "the exhaustion of natural resources"?

A. There is no amount deducted in these calculations as shown on Exhibit No. 92 that is based on the life of the gas field. Does that answer the question?

[fol. 8594] Q. Yes, that answers my question.

A. Very good, sir.

Q. And that is a pretty important element in determining what the value of a property is, is it not?

A. This is the beginning point here. This figure is the beginning point and then we are going to amortize that, which we do in the other exhibits, over 24½ years. We determined the amount per year that should be charged against earnings to cover that.

Q. If you were purchasing a gas property, Mr. Green, and you had two propositions; you had one company whose gas supply was going to last 25 years and another one whose gas supply was going to last only 10 years and, so far as could be observed, the physical depreciation was the same and all other elements were equal, would you pay as much for the property whose gas supply was going to last only 10 years as for the company whose gas supply was going to last 25 years?

A. That all depends on what these two properties are earning, doesn't it? What I would pay for it would depend on what they are earning.

Q. I said all other things being equal, the same earnings.

A. If the conditions are all the same, there would be no difference because you get your money back at the end of 10 years on the one company and you get it back in 20 years, did you say, on the other company and you only get

[fol. 895] a certain fair return per year on the amount you pay for the two properties.

Q. Would your answer be the same if there were only one year remaining gas supply on the property—

A. (Interposing) If the company was receiving all of these factors and elements that they should receive, there would be no difference.

Q. In other words, you would amortize in the last, single, remaining year of the life of the property which I have described, the entire investment and shut your eyes to the amount that has been accumulated on the books of that company for that purpose in the past?

A. What was accumulated on the books of the company prior to regulation, I do not think is important or of any use and we have not used it in any way in preparing these exhibits.

Q. Mr. Green, you started on June 30, 1941, notwithstanding the fact that the Natural Gas Act became effective in the middle of 1938, didn't you?

A. Yes, but I think in the Natural Gas Pipeline of America case, that the Circuit Court, at least, gave some statement on that. I have forgotten exactly what it was but the time element here is so short between the two dates, that it would not be material.

Q. Two and one-half years is not material?

[fol. 8596] A. What?

Q. Two and one-half years is not material, in your opinion?

A. It would not have made any difference in these calculations here.

Q. Probably not the way you calculated it, Mr. Green, but I am asking you why you did not start your calculation on the date the Natural Gas Act became effective rather than as of June 30, 1941?

A. We could have made calculations and determined value as of that date. It probably would make no difference.

Q. It probably would have been better, did you say?

A. No, I do not think it would make any material difference.

Q. Mr. Green, if you sent your engineers out to make a depreciation study by the observation method one day be-

fore the exhaustion of the natural gas supply, would they find any different percent condition than that which they would find if there were an inexhaustible gas supply on that property?

A. Are you referring to this assignment here, the comparable assignment here?

[fol. 8597] Q. I am referring to the method used by your engineers, yes.

A. If the engineers would go out on this property, as they did, the percent condition that they would find would be the same whether the expected life of the gas reserves was one year or 100 years.

Q. Or one day or 100 days?

A. Correct. The life of the field has to do with the period of amortization. We are speaking here of determining values as of some date, which was June 30, 1941.

Q. Well, aren't your engineers, when they ignore the fact that the gas supply in one instance is to be exhausted within one day after they examine the property, ignoring a very important element that goes into the determination of the value of the property?

A. There is a percent condition based on the original cost of the property. Now, whether the property is going to be used one day or 10,000 days after that date is not an element that they even should consider in determining the percent condition of value. There is no relation between the two points. One has to do with determining value and the other thing that you are discussing is the period of amortization.

Q. In other words, when you go about to make a determination of the amount of dollars to be provided annually for depreciation, you take into account the important factor of the claimed exhaustion of the gas supply; [fol. 8598] but when you go about making a determination of the amount of depreciation to be deducted from the rate base for rate making purposes you ignore that fact. Is that what you say?

A. Not at all. I do not believe you have stated your own position there. I believe you have confused the two elements there.

Q. What is there about my question that seems to be confusing to you?

A. I am reminded of the story of the chap that says, "Do you see that big red house?"

"Yes."

"Well, that is not the one."

Q. Well, perhaps we can get at it this way, Mr. Green: You have stated that your deduction from original cost for depreciation does not reflect anything that has not been provided for in the past by way of amortizing the property over the life of the gas supply.

A. In Exhibit 92 the book depreciation is not reflected.

Q. But when you set up your annual allowances in Exhibit No. 104 you do include that element, do you not, namely, the element of making a provision for the amortization of the property over the life of the claimed gas supply?

A. Correct.

Q. Do you believe in harmonizing the annual allowances [fol. 8599] for depreciation with the amount to be deducted from original cost for depreciation?

The Witness: Will you read that?

(Whereupon, the pending question was read by the reporter.)

The Witness: I do not understand your question, Mr. Littman, and I am not trying to be evasive, sir.

By Mr. Littman:

Q. Yes. Well, I think I can make it clear by reading an excerpt from the Commission's Opinion No. 63 in the matter of Chicago District Electric Generating Corporation, Docket No. IT-5500:

"The true conception of depreciation leaves no room to doubt that annual depreciation expense and actual depreciation must be harmonized. Annual depreciation measures the diminution in service life, capacity or utility in one year—actual existing or accrued depreciation is the total diminished service life, capacity or utility to the date of inquiry. To accept the one while denying the other is to be illogical and guilty of employing dual standards

with resulting injustices to the public or to the utility. The principles are identical which govern the estimate of loss in service capacity for both accounting and valuation purposes."

Do you subscribe to the principles which I have just read?

A. I do not as applied to the Exhibit 92.

Q. Well, of course, if you have not applied the Com-[fol. 8600] mission's principles for purposes of Exhibit No. 92, which is one part of the harmonizing feature, you, of course, are saying that you have not applied the Commission's rule at all, isn't that true?

A. I think in my direct testimony, as well as in my testimony this morning, that I answered that question.

Q. Affirmatively?

A. No.

Q. Well, have you in respect to Exhibits Numbers 92 and 104 harmonized annual depreciation with accrued depreciation as that term is defined in the Commission's opinion in the Chicago District Electric Generating case?

A. Exhibit 92 is determined value as of June 30, 1941. We used that value, which is original cost depreciated to percent condition, and determined the annual dollars necessary to amortize that original cost investment.

Q. Now, will you answer my question, please, Mr. Green?

The Witness: Will you read the question?

(Whereupon, the question commencing at Line 9 of this page was read by the reporter.)

The Witness: I cannot answer the question.

By Mr. Littman:

Q. Why can't you answer the question. Isn't it clear?

A. Well, I think I clearly stated how we had determined Exhibit 92; the figures shown there, and how we used them [fol. 8601] in Exhibit 104. Now, if you want to make any comparisons with the method that I have set up here as against any Commission ruling or any Court ruling, it is perfectly all right. That is your business, but I do not want to be interpreting some Court decision or some Commission's decision.

Q. Well, I have read you an excerpt from the Commission's opinion in the Chicago District Electric Generating case and I merely asked you whether you applied those principles to your depreciation studies which you have offered in this proceeding?

A. Mr. Littman, the two cases are not comparable. The Chicago District Generating Electric Company is a utility with an infinite life. This property here is a property that has had regulation over many years, too, by the way.

Mr. Baldrige: You mean—

The Witness: (Interposing) In the Chicago District Electric Generating case.

Here you have a business that is taken over—I don't know, I am using the words "taken over" advisedly, but they have taken over the property as of the date of regulation when the Act was started. Prior to that there was no regulation of the natural gas pipe lines. Here we have a property with a finite life and the two cases are not comparable in any way, in any opinion.

Q. Are you saying that on a property with a finite life [fol. 860] that the Commission's principles, which I have read to you, cannot be applied?

A. Well, the principles that they are referring to there, as I remember your reading that statement, they are referring to an entirely different situation, entirely different conditions than we have in this case here, entirely different; the two are not comparable.

Q. Do you agree with the statement, "Actual existing or accrued depreciation is the total diminished service life, capacity or utility to the date of inquiry"?

A. With a business that has been regulated throughout as the Chicago District Electric Generating Company has and which has an infinite life.

Q. Does Exhibit No. 92 have any figure thereon that represents "actual existing or accrued depreciation", as measured by the "Total diminished service life, capacity or utility to the date of inquiry"?

A. If the measured life that you speak of is on the straight line depreciation, it does not.

Q. Well, you do not agree with this principle anyway, do you, that I read to you from the Chicago District Electric Generating case?

A. I do not think that the value of all property in the public utility business, each item of property, decreases in the same amount from year to year as you would set up [fol. 8603] on a straight line basis. I think that is purely an accounting device for amortization of property values and that does not mean that the value of that property goes off in the same direct proportion, and it does not, either.

I will give an example. In my opinion a compressor station that is similar to the ones that are installed and in use by this company, that the actual value in dollars of one of those compressor stations is greater, the value is really greater one year after it is installed and operated than it is the day it is installed and has never been rolled over or used for the obvious reason that some use of that equipment should get all the bugs out and it really has a greater value than it did the date that it was first installed.

Q. You think that the consumer should pay a return upon the unearned increment which represents the additional value that you have just described?

Mr. Culton: I would like to know what that is.

The Witness: No, Mr. Littman, when we determined the annual amount here for amortization, it is based on straight line discounted.

By Mr. Littman:

Q. Now, Mr. Green, what I want to do is to discuss your example. What you are saying is that if a compressor engine is installed today at a cost of \$100,000 that it is worth more a year from today by reason of the fact that [fol. 8604] it has been worked for a year and operates a little more efficiently than when first installed. Is that right?

A. May I state what I meant by that statement?

Q. Yes.

A. You install a compressor station today that costs \$100,000 and it is placed in operation and we will assume

that that compressor station has a finite life of 25 years. The annual depreciation rate would be 4 percent of the \$100,000 or \$4,000. My point is that at the end of one year the value of that compressor station would be greater than \$100,000 less \$4,000 or \$96,000.

Q. And you would have the ratepayer pay on the basis of what you call the present value. Is that right?

A. No. We were determining the value here as of June 30, 1941, that is what we were determining here. Then, we start from that day and we depreciate it on the straight line basis, discounting the amount to go into a fund compounded semiannually as shown later in the exhibits and which develops the sinking fund method.

Mr. Goodman: Well, you do not answer Mr. Littman's question: Now, who is going to pay you that appreciated value?

That is what I think he means.

The Witness: What we were trying to determine in Exhibit 92 is the value based on original cost of this property as of June 30, 1941. Now, let's get that clear. That is [fol. 8605] the purpose of this exhibit.

By Mr. Littman:

Q. Mr. Green, I am asking you to talk about your own hypothetical case of a compressor engine installed today, having a value of \$100,000.

A. Yes.

Q. Now, you say that if it is five years old and has an over-all life of 25 years and has a remaining life of 20 years that for bookkeeping purposes the reserve would be 20 percent, let us say, 20 percent.

A. Yes.

Q. Of the original cost.

A. On straight line.

Q. Or \$20,000.

A. On straight line, yes sir.

Q. Now, by the observation method, according to you, you would not find anything like \$20,000 of depreciation on that station, would you, on that compressor engine?

A. If you were determining value, not amortization, but if you were determining value as of that date.

Q. By the observation method?

A. Yes, you would not. They would not be the same.

Let us put it this way: Suppose the compressor station cost \$100,000 and we will suppose that the life of the gas field is only two years. All right, one year later you would [fol. 8666] have amortized 50 percent of that station, wouldn't you? It would be \$50,000. I am claiming that the value of that compressor unit might be \$75,000 as of one year hence, although the books would reflect that you have written off 50 percent of the amount.

Q. Now, Mr. Green, let's go back to your original illustration and not confuse the issue. We have a compressor engine installed today at an original cost of \$100,000. The over-all life of the gas supply is 25 years and 5 years have elapsed. You will have provided 20 percent of the original cost or \$20,000 in a depreciation reserve to take care of the amortization. Is that right?

A. Five years hence it would be that.

Q. That is right.

A. From now.

Q. You have that?

A. Yes, that is correct.

Q. Now, you have stated that for rate making purposes you would not use the remaining \$80,000 as the rate base, because you say that does not represent the value of the machine. Is that right?

A. No, sir, that is not correct, for this reason: You get the two dates wrong. You say "if you built a compressor station today." If we built it today, the Natural Gas Act is in effect, so you spend the dollars today and you are as [fol. 8607] summing that the life of the field is 25 years. Five years from today you will accrue 20 percent. Correct? But you would not determine any value then.

Mr. Goodman: Why not?

The Witness: What would use the figure for, sir? It has nothing to do.

Mr. Goodman: Suppose we have a rate case at that time now?


The Witness: It would not make a bit of difference. You would not use this percent condition at all under this case.

now that you are going to build it today. You do not use percent condition.

Mr. Goodman: That is exactly what we want to find out. In other words, because the Natural Gas Act is in effect and for a property on which the Natural Gas Act has been in effect from the beginning, you would say that percent condition is inapplicable in determining the rate base?

The Witness: Percent condition would have nothing to do with the rate base; under the theory I have set up here you know what the original cost is. You built it today under the Natural Gas Act when it is in effect.

Mr. Goodman: And the only reason that you have used percent condition in this case is because you claim that, in the absence of regulation, the property is worth at least its original cost less an amount deducted dependent upon [fol. 8608] its percent condition?

The Witness: Correct, yes, sir. 

Mr. Goodman: And that is the justification for your percent condition in this case, namely, you felt that you should determine a value apart from regulation?

The Witness: Apart from regulation?


Mr. Goodman: Yes.

The Witness: What do you mean "apart from regulation"?

Mr. Goodman: In the absence of regulation.

The Witness: No, the property was prior to regulation, so what we are trying to arrive at here is the value as of the date of regulation.

Mr. Goodman: That is it. Now, you determined that, you say, on a structural value?

The Witness: Percent condition of original cost. 

Mr. Goodman: By the way, is the term "structural value" familiar to you?

The Witness: No.

Mr. Goodman: I see, all right. Now, then, had regulation been in effect prior to 1936, you then are clear that that

method of determining the present value of the property would not be applicable?

The Witness: By this method?

Mr. Goodman: Yes.

The Witness: It would not.

[fol. 8609] Mr. Littman: By "this method," you mean the observation method?

The Witness: Yes. It would not.

Mr. Baldridge: That is based on the fact you used original cost as a rate base?

The Witness: That is correct. In other words, if the Natural Gas Act had been in effect in 1933—

Mr. Goodman: (Interposing) Yes.

The Witness: (Continuing) —or prior to when this property was constructed, you would not use this method at all, sir. I would not use it.

Mr. Goodman: Now, will you tell me what method you would use?

The Witness: As I have applied it here to Exhibit No. 104?

Mr. Goodman: No.

The Witness: I mean if I was running the whole show?

Mr. Goodman: No, assuming regulation had been effected since the inception of the investment.

The Witness: Yes.

Mr. Goodman: What method would you use to accomplish a revaluation?

The Witness: I would not have any revaluation, sir.

Mr. Goodman: You would not find it necessary?

The Witness: It would not be necessary, no. You would not determine the percent condition. It would not be needed.

[fol. 8610] Mr. Littman: You would use the original cost less the reserves for rate base?

The Witness: If you use original cost as the rate base as we have done here, with certain corrections due to the purchasing power of the dollar, if you use original cost as the rate base and the sinking fund method, you do not deduct book depreciation.

By Mr. Littman:

Q. Suppose you used the straight line method of setting up annual allowances for depreciation, would you then deduct the depreciation reserve from the original cost?

A. No, you use the average investment over the life. You get the average investment over life.

Q. Even then you would not deduct the depreciation reserve? A. Yes, you do.

Q. You do?

A. On the straight line method, say you have a property with a life of 25 years, it is 4 percent per year. Now, under the straight line method, you start off the first year with \$100. You earn on \$100, don't you? The second year, you have \$96 left in the business, the third year \$92 and so on down, but to determine the amount that this company should earn per year, you average that and you get the average investment. Otherwise, you would have to [fol. 8611] adjust rates each year which, of course, you would not want to do so you use the average investment.

Mr. Goodman: Now then, you have pointed out that, as you would apply it, there is little, if any, difference between the straight line method and the sinking fund method in its application, haven't you?

The Witness: In my opinion, there is no difference.

Mr. Goodman: You mean in their use in determining the proper price of service, that is the way you mean it?

The Witness: Yes, how much should this company earn—

Mr. Goodman: (Interposing) In a calculation of rates to determine the proper price of service, there is no difference in the result?

The Witness: Whether you use straight line or the sinking fund method—

Mr. Goodman: (Interposing) All right.

The Witness: (Continuing) —both properly applied.

Mr. Goodman: Now, is that comparability, in your mind, predicated upon the basic thought that you should, in applying the straight line method average the investment outstanding over the life of the property?

The Witness: That is correct.

Mr. Goodman: In other words, let's take this example: Let's get down to a 40-year, \$100 value, having a 10-year life and no salvage. Now, on the straight line method, [fol. 8612] that property will decline in value from \$100 to \$10, is that right, or to zero?

The Witness: To zero, correct.

Mr. Goodman: So the average investment will be \$50, is that right?

The Witness: That is right.

Mr. Goodman: Consequently, you would use \$50 as your rate base?

The Witness: The average.

Mr. Goodman: For the price of service.

The Witness: That is correct, roughly.

Mr. Goodman: And that would make it comparable to a price of service determined by the application of the sinking fund method, is that correct?

The Witness: That is correct.

Mr. Goodman: Well now, let's try it a different way that I think will make the thing more clear because I am not sure about the applications of an average property value. This much is clear, that if you compute the price of service under the straight line method and assume that you want your concern or your unit or your enterprise to make 6 percent on its investment, it would have to charge,

in the first year, \$10 for depreciation, \$6 for return or \$16, is that correct?

The Witness: Correct.

Mr. Goodman: Now, in the last year, you would have to [fol. 8613] charge for service \$10.60, isn't that right?

The Witness: That is correct.

Mr. Goodman: Now, if you took \$16 and \$10.60 and you averaged that, you would get a figure of about \$13.50, wouldn't you?

The Witness: Average.

Mr. Goodman: An average?

The Witness: That is right.

Mr. Goodman: Average price for service for annual output, is that right?

The Witness: That is right.

Mr. Goodman: And it so happens that that figure would compare with the result under the sinking fund method, isn't that so, which is exactly \$13.59?

The Witness: Assuming your mathematics is correct, the principles, I agree with you. There is no difference at all between the two.

Mr. Goodman: There is no difference?

The Witness: Under the sinking fund method, you will come out with the same annual amount per year for amortization plus return on the investment.

Mr. Littman: Using the same rate of interest for the sinking fund as you used for a return, is that right?

Mr. Goodman: What happens—

Mr. Baldridge: (Interposing) I submit the witness can [fol. 8614] only be expected to answer one question at a time.

Mr. Goodman: The question is mine and I am going to rephrase what Mr. Littman has in mind.

Now, it happens that these figures come out approximately correct where a 6 percent rate is being applied. Would you say that they come out in the same way with respect to any rate of interest?

The Witness: Correct.

Mr. Goodman: They will?

The Witness: Yes.

Mr. Goodman: Have you figured it out? Have you tried the calculations?

The Witness: I mean the two, the sinking fund method as against straight line, would be the same whether you used 8 percent as a fair return or 4 percent as a fair return.

Mr. Littman: Provided you used the same rate of interest?

The Witness: In both calculations, yes. That is what I mean to say.

Mr. Goodman: Have you gone through those calculations to see if that is right at any time?

The Witness: I would not have to go through them.

Mr. Goodman: You are sure they would come out that?

The Witness: Yes, sir.

Mr. Goodman: Now you realize, Mr. Green, that your application of the straight line method is not the conventional one, isn't that right?

The Witness: We have not used the straight line method—

Mr. Goodman: (Interposing). Nevertheless, you realize that your qualification of the straight line method, that is, by averaging the value at the beginning and end, from the initial value to zero or averaging the return requirement from, in the example I gave you, \$6 to \$10.60, is not the conventional application. You know that?

The Witness: No, in any rate case I have ever been in, it has always been done the way I say. You take the

average investment. Now, of course, a property with an infinite life, you have got different problems entirely than you have here with a property with a finite life. I want to say that again. They are entirely two different problems.

Mr. Goodman: Do you think, Mr. Green, that by using, in the example I gave you, the averages which you have mentioned that one can, with a fair degree of accuracy, calculate the decline in value year by year which would ensue under the hypothesis? Do you follow me?

The Witness: I do not.

Mr. Goodman: Would this method then—

The Witness: Interposing) Which method?

Mr. Goodman: We'd this method of computation by the straight line method which you advocate and its application which you advocate, result in an approximate determination of value year by year under the hypothesis of the problem, that is, the 10-year life, constant service and no salvage at the end?

The Witness: Well, if you were to charge the ratepayers per year the amount that you gave, \$10 or \$16 the first year?

Mr. Goodman: Yes.

The Witness: And down to the last year, the ratepayers would pay \$10 plus 60 cents.

Mr. Goodman: You do not think that is right, do you?

The Witness: Well, I think it would be almost impossible to run a business that way because you are going to be lowering rates each year.

Mr. Goodman: Now, it would not occur to you, Mr. Green, that the freight consignee should pay a less sum depending on whether the freight was hauled in a new car or an old one?

The Witness: I would not think so, no.

Mr. Goodman: In other words, if the car was about to be retired the next day, he should not receive a discount

because his freight was hauled in an old car over what he would pay if the freight was hauled in a new car?

The Witness: I would not think so.

Mr. Goodman: In other words, the value of the service he received is the same, regardless of the age of that property, isn't that right?

The Witness: That is correct, and the cost of that service [fol. 8617] has been the average life of the car.

Mr. Goodman: And that is why, if you charge your customers approximately \$13.30 then, that being the average figured on the straight-line method, you would say that that would approximately be a fair price for service to yield the utility 6 percent throughout the life of the unit?

The Witness: That is correct.

Mr. Goodman: And it will do that, too?

The Witness: It will do that, that is right.

Mr. Goodman: Now, on the basis of those facts, the unit will decline in value according to a certain mathematical rule, won't it? If you assume these facts to be true—

The Witness: (Interposing) I do not know why you are now bringing in this question of value.

Mr. Goodman: You do not want it?

The Witness: I see no application.

Mr. Goodman: All right. You would say there is no need to revalue that unit at any time?

The Witness: Not at all.

Mr. Goodman: That, once having established the correct price for service, there is no reason why that should not stay that way as long as our conditions are maintaining themselves in effect?

The Witness: And the value of the dollar remains the same.

Mr. Goodman: And if you got new conditions as, for [fol. 8618], example, an extension of life—

The Witness: (Interposing) Taxes.

Mr. Goodman: (Continuing) Or the need for some enhanced rate of return, that would be the time to make an application of some new rate?

The Witness: That is correct.

Mr. Baldrige: May I ask a question there? In speaking of the average investment, you mean to include, of course, the investment that is made during the remaining life of the enterprise, don't you, Mr. Green?

I mean, you have been talking about an assumed case where you had a certain investment in an enterprise.

The Witness: And no property additions are assumed.

Mr. Baldrige: And no property additions?

The Witness: That is correct.

Mr. Baldrige: But you would have to take all property additions into consideration?

The Witness: Yes, if there were property additions made, it would change your calculations, of course.

Mr. Baldrige: And if you started with a calculation based on averages over the life of the enterprise, that average, to be accurate, would have to include all property additions made in the future as well as those made in the past?

The Witness: That is correct.

[fol. 8619] By Mr. Littman:

Q. Mr. Green, I am going to read you from Mr. Haberly's testimony at Page 8096 of the transcript. Incidentally, you know Mr. Haberly, do you not? A. I do.

Q. And you consider him a competent engineer?

A. I selected him to do this work.

Q. I read from the transcript:

"Q. Now, where original cost is used, Mr. Haberly, you would feel that it was proper, would you not, to make a deduction for depreciation that has accrued by reason of the claimed exhaustion of the gas supply?"

"The Witness: May I hear that question?"

Q. The Witness: It would depend on whether the reserves for depreciation were being accrued on a straight line or sinking fund basis.

A. By Mr. Littman:

Q. Assume that the company in question is one which is accruing its reserves for depreciation on a straight line basis.

A. My own personal feeling in that case is that the depreciation should be deducted.

Q. For the assumed exhaustion of the gas supply so as to reflect that element, is that right? A. Yes.

[fol. 8620] Q. Do you agree with Mr. Haberly's testimony which I have just read?

A. What was this line of examination about, determining what?

Q. Can you understand what we are talking about, from the excerpt that I have read, Mr. Green?

A. No. What were you cross-examining him about then? Was it this exhibit here ((indicating))?

Q. Yes, I was cross-examining him—

A. (Interposing) On Exhibit 92?

Q. I was cross-examining him about Exhibit No. 92, yes.

A. Well, if I understood correctly, I do not agree with that statement.

Q. Now, it has already been stated on this record that the depreciation reserves on the books of the company at June 30, 1941, amounted to \$1,526,600. Do you remember that? A. Yes, sir.

Q. Now, the company has collected that amount out of its rates, has it not? A. They have.

Q. By charges to operating expenses? A. Yes.

Q. And through charges to its customers? A. Correct.

Q. Now, what you are doing is to request that, for [fol. 8621] purposes of this proceeding, the largest part of that, namely, all except \$310,226.50 be again collected from the consumers, isn't that the effect of your method?

A. No. In determining the value as the date rate making starts here, you get a certain value. From there on, we want to amortize that value and that is what we have here when we get \$11,951,034.05.

Q. And if we were to follow your method, we would then return to the company again all of the amount of \$1,526,600 which the company has collected in the past except \$310,226.50 which latter figure represents the observed depreciation. Isn't that the effect of your method?

A. The effect would be your returning to the stockholder the value of the property as of June 30, 1941.

Q. And you make the duplication that I have just indicated, do you not?

A. I do not. I am not saying there is any duplication.

Q. You are not saying there is not any duplication?

A. No. What happened prior to regulation, I think has nothing to do with this case. Whether they set up one percent or 10 percent depreciation per books would have nothing to do with this case and nothing to do with determining value of the property as of June 30, 1941.

Q. And under your method, the investor receives again the amount which he has heretofore collected for depreciation?

[fol. 8622] A. No, I do not know whether he has received this or not.

Q. He received a large part of it, has he not, Mr. Green, it is obvious.

A. If you mean to ask me this question, Mr. Littman: The original cost of this property less observed depreciation which is given at \$310,000 leaves you a net amount of \$11,951,000, is that amount, \$11,951,000 greater than the original cost less the book depreciation as of June 30, 1941, my answer is yes.

Q. What I am asking you is whether or not, under your method, you are again providing for a return to the investors of the amounts which they have already recouped through their past charges to amortization? You can answer that yes or no.

A. I might be wrong, Mr. Littman, in my concept of how to determine value at the date of regulation here. I might be wrong about that. I am not trying to be evasive about answering your question. I am saying what the company charged on its books, whether it had any earnings in those prior years prior to regulation, I do not

think has anything to do with this question we are trying to determine.

Q. In other words, it has nothing to do with it even though the company has already collected?

A. It has nothing to do with it, whether they have collected or have not collected, yes, sir.

[fol. 8623] Q. And even though your method does result in a duplication in recoupment of those amounts?

A. I did not say that.

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[fol. 8624] Q. Mr. Green, will you please turn to Exhibit No. 93 entitled, "Michigan Gas Transmission Corporation—Statement of Contributions Made to Customers for Business Development for the Years 1936-1937 and Five Months Ended May 31, 1938 (Effective Date of Natural Gas Act June 21, 1938)"?

Do I understand that you have assumed the responsibility of causing this exhibit to be prepared?

A. That is correct.

Q. You have excluded in your pro forma rate base the amount of \$182,626.69 which represents the total of the contributions made by Michigan Gas to its customers for what you term "business development" during the years stated in the title of this exhibit? A. Yes, sir.

Q. And all of these amounts have been originally charged by Michigan Gas to operating expenses?

[fol. 8625] A. That is correct.

Q. Mr. Spitznagle has testified that these amounts have been charged to the operating expense account called "Sales Promotion Expense." Is that your understanding? A. Yes, sir.

Q. No such amount as \$182,626.69 appears in the capital accounts of Michigan Gas? A. It does not.

Q. Weren't these amounts properly charged by the company to sales promotion expense?

A. That would be a matter of business judgment.

Q. What is your judgment on the subject?

A. Personally I think that an item, an expenditure such as these items here, which was to reimburse the local company for what we call change-over expense from arti-

ficial gas to the use of straight natural gas,—it was an inducement to customers to change-over to use the service of the pipe line company and the benefits of that expense on the part of the company should be spread over the life of the business rather than charged right off in the immediate year. That is my opinion. Since these expenditures were all made and charged off prior to regulation, I think it is a proper amount. If you are going to take over this business for regulation as of June 30, 1941, I think that this amount should be included in capital to be amortized over the 24½-year period.

[fol. 8626] Q. Now, if what you suggest be done were done you would have it both ways, first, on the books of the company as originally charged to expenses and now in capital, wouldn't you?

A. It was charged to expenses per books.

Q. And now you propose to put it in capital?

A. I propose to add it to an amount here which we build up as the rate base.

Q. Then, your answer to my question is yes?

A. Well, I am not proposing that we make any entry on the company's books here. That is why I hesitated to say yes or no. I do not recommend that they make any entry on their books to credit operating expenses and charge operating expenses, credit operating expenses and debit the capital account.

Q. Well, if what you suggest be done is proper, why don't you recommend that it be properly recorded on the company's book as capital?

A. Well, this company is a subsidiary of a holding company and comes under the Holding Company Act and I do not believe that those rules and regulations would permit any such journal entry.

Q. Neither would the Federal Power Commission permit any such journal entry?

A. No, they would call it a write-up.

Q. That is what it would be, wouldn't it, Mr. Green?

[fol. 8627] A. It would be, yes. Not as the word is generally used, "write-up," no, no.

Q. Are you proposing that this Commission include a write-up in the rate base for the purposes of determining the reasonableness of the rates in this proceeding?

A. I am proposing that this Commission add to the original cost. We have here shown this amount in order to determine a rate base for this company, yes, sir.

Q. And, as you have suggested, if this amount were put on the company's books in its capital accounts today, it would be a write-up?

A. I say you would call it a write-up.

Q. I would. Wouldn't you?

A. No, no, just correcting a former entry, that is all.

Q. Well, is there any doubt in your mind, Mr. Green, that the company has already recovered this \$182,626.69 from the ratepayers through the medium of past rates?

A. It was charged to operating expenses, these items were, prior to regulation.

Q. Can you answer my question yes or no?

○ The Witness: You will have to read the question.

(Whereupon, the question commencing at Line 15 of this page was read by the reporter.)

The Witness: No, there is no doubt in my mind but what that is the case.

[fol. 8628] By Mr. Littman:

Q. As a matter of fact, Mr. Green, expenses of this character, which have been incurred since June 21, 1938, down to the present time, have been currently charged to operating expenses of Michigan Gas?

A. That is correct.

Q. You consider that a proper way of recording the matter on the books of the company, do you not?

A. No, as I say, I think an item such as these, such as shown here, it would be better accounting to charge them into capital than to spread them over the remaining life of the enterprise than it is to charge them all into current operating expenses.

Q. In your pro forma statement, Mr. Green, have you made an adjustment to capitalize the current expenses of this character?

The Witness: Will you read that please? I am sorry.

(Whereupon, the pending question was read by the reporter.)

The Witness: We have added these amounts to the original cost less the percent condition to build up a rate base.

By Mr. Littman:

Q. For rate making purposes?

A. For rate making purposes, correct.

Q. Let's look at Exhibit 104, your pro forma statement,

This exhibit was prepared for rate making purposes, [fol. 8629] was it not, Mr. Green? A. Yes.

Q. Now, look at the item of \$969,993 appearing in the first line called "Utility Income—Per Books Adjusted—12 Months Ended June 30, 1941, Exhibit 100." Do you find that item? A. Yes.

Q. That item includes whatever sales promotion expenses were incurred by the company during that 12-months' period, does it not?

A. I imagine that it does, Mr. Littman.

Q. Mr. Spitznagle I believe has so testified.

A. Yes. I do not know whether there was any such change-over expense during that year or not. I do not know.

Q. You did not instruct Mr. Spitznagle to revise that figure so as to change the amount charged to operating expenses on that account to fixed capital, did you? A. No.

Q. In your Exhibit 104, Page 2, you apply a return of 7½ percent to the full amount of \$182,626 of "Contributions Made to Consumers for Business Development."

A. I do not find that item.

Q. Exhibit 104, on Page 2.

A. Well, there is shown there the cost of developing business, Exhibit 93, \$182,626.

Q. What ultimate rate of return do you apply to that? I [fol. 8630] will ask you not to read the factor but to read the ultimate rate of return applied against that amount.

A. 6½ percent.

Q. After adjustment it became 7½ percent?

A. Well, this formula that I have set up, using Mr. Haberly's testimony regarding the purchasing power of the dollar to get 7.54—

Q. (Interposing) That is what I meant.

A. That is applied to that amount, yes, sir.

Q. Now, when you apply this $7\frac{1}{2}$ percent retirement—

A. (Interposing) I am sorry. I am not correct. It is $6\frac{1}{2}$ percent when applied on the cost of developing business. $6\frac{1}{2}$ percent. We did that for this reason, Mr. Littman: Theoretically, to be consistent all the way through with this formula, we should have applied this 7.54 but we did not have any testimony in the case referring to the purchasing power of the dollar and this cost of developing business, so, therefore, we used $6\frac{1}{2}$ percent.

Q. As against this \$182,626 item?

A. That is correct, yes. I was on the conservative side and we thought it would be more consistent.

Q. Now, will you please compute for me the rate of return per year on this cost of developing business that you allow in dollars for purposes of your pro forma statement? A. \$11,870.

[fol. 8631] Q. Now, you propose that a return of $6\frac{1}{2}\%$ be allowed each year for the remaining $24\frac{1}{2}$ years of the claimed life of the business, do you not?

A. That is correct.

Q. That would come to \$290,815, would it not?

A. I have not calculated it. I am assuming that your figure is correct, $24\frac{1}{2}$ times \$11,870.

Q. That is right? A. Yes.

Q. If our arithmetic should not be correct, you will correct us, will you? A. Yes.

Q. Now, you also provide an annual amortization allowance for each of the remaining $24\frac{1}{2}$ years for the purpose of amortizing this base amount of \$182,626, do you not?

A. That is included in the amount that we amortize on the sinking fund method, compounding at $6\frac{1}{2}$ percent for 50 percent of the investment and $2\frac{1}{2}$ percent on the remaining 50 percent of the long-term investment.

Q. According to our calculation, over the remaining life of the property your annual allowance would amount to \$133,476, computed at the rate of 2.983126 percent.

A. What is that figure?

Q. That is the total amortization allowance to be charged to operating expenses over the $24\frac{1}{2}$ -year period [fol. 8632] which you allowed and the interest rate which I have read.

A. No, in Line 13 of Exhibit 104 the amortization of the long-term investment and cost of developing business, based with respect to each 50 percent of this investment at its respective annual amounts which were $6\frac{1}{2}$ percent compounded semiannually and $2\frac{1}{2}$ percent compounded semiannually, will recover the investment, the amount being \$333,935 per year.

Q. There isn't any doubt that you did amortize this \$182,626? A. Yes, yes.

Q. On a sinking fund basis, of course? A. Correct.

Q. Let us see what that amounts to, Mr. Green. The company has once recovered the amount of \$182,626 through the medium of past operating expenses, is that right? A. That is correct.

Q. In addition, you propose to allow a return upon that amount at the rate of $6\frac{1}{2}$ percent for purposes of your pro forma statement over the remaining claimed life of the property for $24\frac{1}{2}$ years, totaling \$290,815. Is that correct?

A. I do not know where you get that figure, Mr. Littman. That is $6\frac{1}{2}$ percent times—

Q. (Interposing) Yes, $6\frac{1}{2}$ percent times \$182,626.

A. Times $24\frac{1}{2}$ years?

Q. Times $24\frac{1}{2}$ years, yes. If our arithmetic is correct, you will allow a total return over the remaining $24\frac{1}{2}$ years of \$290,815 on this so-called cost of business development of \$182,626.

A. No, you see, Mr. Littman, under the sinking fund method, you use the full rate undepreciated, don't you, throughout in determining the amount which you charge against operating expenses but part of that amount is a return in capital and that is how, if you are using $6\frac{1}{2}$ percent in today's dollars, that is how you get the earnings into the company which must be returned to the investor annually.

Do I make myself clear?

Q. Well, regardless of that, Mr. Green, you are allowing $6\frac{1}{2}$ percent return on this \$182,626 down through each of the remaining $24\frac{1}{2}$ years?

A. No, it is averaged. You come again there to the same thing we were talking about this morning, the average investment.

Q. You just explained that you made no deduction from the \$182,626 through the years.

A. No, but that is not all income is what I am saying. You calculated it that way, 6½ percent times \$182,000 and that amount is included in utility income allowable that I show on Exhibit 104 in the amount of \$954,572.

Mr. Goodman: I think I understand Mr. Green's theory very thoroughly and it can be cleared up if I ask a question or so for the purpose of bringing out what he means.

Mr. Littman: Go right ahead, Mr. Goodman.

Mr. Goodman: You mean that you take 6½ percent of your beginning value and you derive a result from that which you refer to, not as the depreciation for all the years, but as the amortization sum or amount, pure and simple. Is that right?

The Witness: Part of that.

Mr. Goodman: That is the amount that you are going to set aside, literally or figuratively, for purposes of amortization?

The Witness: That is right.

Mr. Goodman: But part of that is return and part of that is interest?

The Witness: Correct.

Mr. Goodman: But regardless of how much is interest of return in any one year as your base declines, the amount of interest is allocable or apportionable as 6½ percent on the declining base?

The Witness: That is correct.

Mr. Goodman: And it works out that way?

The Witness: That is right.

Mr. Goodman: I will say, too, it does also.

By Mr. Littman:

Q. You mean to say that this amount of \$182,626 will [fol. 8635] not remain constant through the remaining

24½ years but will grow less and less in terms of depreciation, that it will be depreciated through the years?

A. It is depreciated through the years.

Q. It is depreciated through the years? A. Yes.

Q. Does your annual allowance on this item increase or decrease or stay constant?

A. Your annual allowance—are you referring to interest or income?

Q. No, I am talking about the annual allowance for amortization on this \$182,000. A. That is a fixed amount.

Q. That is a fixed amount? A. Yes.

Q. I thought you deducted only observed depreciation from your rate base. Can you observe any depreciation on sales promotion expense?

A. I say we did not. That is used—

Q. (Interposing) Mr. Green, you do propose to secure a 6½ percent return on this \$182,625 of sales promotion expense right down through the years, don't you?

A. May I give you an example of that?

Q. Yes, I wish you would.

A. You start off with a \$100 investment. Six percent [fol. 8636] on \$100 is \$6. That amount remains constant in this calculation that I have shown on Exhibit 104. The item of \$954,000 is comparable to the \$6 item now. We will assume a 25-year life of the business.

Mr. Goodman: Could you make it 10 with just as much convenience?

The Witness: All right.

Mr. Goodman: The reason for that is I have the 10-year figures in mind.

The Witness: Assuming a 10-year life, at the end of the first year, the investor gets 6½ percent on \$100 and in operating expenses is another item for amortization which would be \$10, using that amount.

Now, the second year you have only \$90 actually invested in the business but we are allowing \$6.50 each year. 6½ percent of \$90 gives you the income that the investor is getting. That amount less the \$6.50 is a return of capital and, for this sinking fund method to work,

the company must give a liquidating dividend each time the payments are made into this fund.

Mr. Goodman: Or you would say, having received the money, it is a matter of indifference to the customer what they do with it?

The Witness: That is right. If they would leave it in the company, then you are not earning on your capital, are you?

[fol. 8637] Mr. Goodman: But the customer, having paid the appropriate rate, is done with the transaction anyway?

The Witness: I think so.

Mr. Goodman: The money is lawfully the money of the company and they are paid out just as if they had taken the return of capital and stuck it in their pocket?

The Witness: That is right.

Mr. Goodman: So the transaction, for the purpose of calculating depreciation, is complete?

The Witness: Yes. I read a brief of the Federal Power Commission in; I think it was the Natural Gas Pipeline of America case where they say in there, this sinking fund method is merely a method of calculation to determine the amount the company should receive annually in earnings but has nothing to do with the books. You do not keep the books that way at all.

By Mr. Littman:

Q. Didn't the Commission use an undepreciated rate base there?

A. That would not make any difference. That would have nothing to do with the calculation.

Q. Didn't you say a few minutes ago, Mr. Green, that you use an undepreciated rate base in connection with the sinking fund?

A. I did not mean to express it that way, I do not believe.

[fol. 8638] Q. You certainly confused me when you expressed it that way.

Mr. Goodman: He means that you can conveniently calculate the amount that way.

The Witness: That is right.

Mr. Goodman: That is what he meant.

By Mr. Littman:

Q. Let me see if I understand you, Mr. Green. There isn't any question that so far as your pro forma statement, Exhibit No. 104, is concerned, you allow 6½ percent on the full amount of \$182,626 business development expense, do you not?

A. Per year, you mean. We allow 6½ percent on that per year.

Q. You allow it certainly for the first year?

A. Each year.

Q. You allow that same return the second year?

A. Pardon me, that is where you are confusing me. You say "return." I say it is that amount of 6½ percent that is allowed on the \$182,626 which is shown as a proper item of expense of the company for each year but that amount does not represent—

Mr. Goodman: And that amount—

Mr. Littman: (Interposing) Suppose you go through that answer and make certain the reporter has it. Will you read it so far as you had gotten?

[fol. 8639] (Whereupon, the last answer was read by the reporter.)

The Witness: (Continuing) For each year but that amount does not represent income to the stockholder.

Mr. Goodman: You mean that it is always in each succeeding year 6½ percent on the unamortized balance?

The Witness: That is income. That would be income.

Mr. Goodman: That would be the income?

The Witness: Yes, sir.

Mr. Goodman: And the amount in addition to that is the return of the capital?

The Witness: Correct.

Mr. Goodman: I have your picture exactly.

The Witness: I did not want Mr. Littman to get confused and think that this $6\frac{1}{2}$ percent, as a return to the stockholder, is that amount per year throughout the life of the project.

Mr. Goodman: The fact remains that when you attempt amortization by the so-called sinking fund method, you reach a result which will give you an amortization annuity, not all of which is return, but a portion of which is return of capital, another portion is earnings on the unamortized balance but if you add the two of those together, you will get a constant which constant is equal to the so-called sinking fund annuity on the original sum with which we start?

The Witness: That is well expressed.

[foi. 8640] Mr. Goodman: That is the mathematical working out?

The Witness: Yes, sir.

By Mr. Littman:

Q. Mr. Green, let's confine ourselves for the minute to the ratepayer. Is the ratepayer going to be required to pay $6\frac{1}{2}$ percent on the full amount of \$182,626 of business development expense in each and every one of the remaining $24\frac{1}{2}$ years of purported life of this company?

A. No.

Q. He will pay it the first year, $6\frac{1}{2}$ percent of \$182,626?

A. Well, in the pro forma statements that we have prepared here, we compound the sinking fund payments semi-annually so, in our setup, you would have $6\frac{1}{2}$ percent for the first six months and, for the second six months, it would be $6\frac{1}{2}$ percent less the sinking fund amount.

Q. Is there any such calculation appearing in your Exhibit No. 104 such as that which you have just described?

A. The principle of the sinking fund basis is part of it. It is the only way you can do it.

Q. We are not talking about the sinking fund. We are speaking about rate of return converted into dollars and cents. Do you understand my question? A. Yes, sir.

Q. Let's not talk dollars; if it seems to disturb you. [fol. 8641] Are you going to apply your rate of return of 6½ percent on the \$182,626 in each of the remaining 24½ years of the life of this property? A. No.

Mr. Goodman: If you will permit me, I think I can have the witness tell you exactly what he is doing so you will all understand.

Will you do that, Mr. Littman?

Mr. Littman: All right.

Mr. Goodman: I know what he is about.

Now, Mr. Green, your object was to regard \$182,626 as a basis for determining a certain portion of the cost of service, right?

The Witness: That is correct.

Mr. Goodman: And you wanted to burden that cost with an amount which would yield 6½ percent on all of the \$182,626 that was, from time to time, outstanding as an investment?

The Witness: That is correct.

Mr. Goodman: So that by the end of the period of amortization, your company will have received its \$182,626 back plus 6½ percent on that amount and out of the allocable portions of that amount which were outstanding over the period they were outstanding?

The Witness: That is right.

Mr. Goodman: That is all there is to it?

[fol. 8642] The Witness: Yes, sir.

Mr. Goodman: Now, gentlemen, I suggest you have the reporter read my questions and Mr. Green's answers, you were in conference there, which I think will clarify just exactly how the witness treated the \$182,626. He answered my questions there which tell you how he treated it.

(Whereupon, the questions and answers indicated were read by the reporter.)

By Mr. Littman:

Q. Is the return plus the amortization on this item constant each year? A. No, it would not be.

Q. The two items combined are not constant in each year?

A. The amount that we set up semiannually is a fixed amount each year to amortize this investment. It is a fixed amount.

Q. How much is it for each \$1,000 of base?

A. On a base of \$14,686,827 the annual amount is \$333,954.

Mr. Littman: Will you read that answer, please?

(Whereupon, the last answer was read by the reporter.)

The Witness: That is for amortization.

By Mr. Littman:

Q. How much is it for return?

A. Referring to my direct testimony, some items are [fol. 8643] 7.54 and some are 6½, the over-all is \$954,572.00.

Q. Does the sum of those two amounts remain constant throughout the life of the property? A. Yes, sir.

Q. So that the ratepayer will pay approximately \$100 per year on each \$1,000 of rate base, approximately?

A. Referring to Exhibit 104, Item 13, you see the total amount is \$1,296,309.

Q. That is the annual return and annual amortization allowance combined, is it not? A. That is correct.

Q. On how much rate base? A. On \$14,686,827.

Q. That is approximately 10 cents per dollar, is it not?

A. It would be about 11, wouldn't it?

Q. It would be a little less than 10 cents per dollar?

A. Nine, yes.

Q. About 9 cents per dollar? A. Yes.

Q. Now, we have \$182,626 of rate base which is represented by these sales promotion expenses. Is that right?

A. That is correct.

Q. And in each year your return plus amortization will amount to something a little less than \$182,626?

A. I imagine that arithmetic is correct. I have not [fol. 8644] checked it out.

Q. It sounds about right to you, does it not? A. Yes.

Q. So that you will give the company over the remaining 24 1/2 year period something more than 2 1/2 times the original amount of \$182,000 by way of return and amortization? A. That is merely arithmetic.

Q. Well, that sounds right to you, does it not?

A. Approximately so, yes, but I hesitate to confuse income with return of capital.

Q. Now, let's see what you have done here for the ratepayer, Mr. Green:

Mr. Culton: You mean by that, Michigan Consolidated?

Mr. Littman: I mean the consumers of Michigan Gas Transmission Corporation.

Mr. Baldridge: We have no consumers. Mr. Littman, we sell only to distributing companies. I just do not like the use of "consumers" in this connection, because I think it gives an inaccurate connotation.

Mr. McRee: You have some very good customers.

Mr. Baldridge: I do not deny that.

Mr. Littman: I take it the issue here is the reasonableness of the rates of gas charged by Michigan Gas Transmission Corporation to its customers.

Mr. Culton: We have had no discussion of that at all [fol. 8645] during the entire proceedings.

Mr. Baldridge: The only purpose of my comment was to take up the use of the word "consumers."

By Mr. Littman:

Q. Mr. Green, let's look at the situation in so far as it affects the rates of Michigan Gas Transmission Corporation with respect to this item of business development expense.

The company has already once recovered the sum of \$182,626 through past operating expenses. Is not that correct?

A. That is correct.

Q. Now, you propose by your setup to give Michigan Gas Transmission Corporation that same amount approximately $21\frac{1}{2}$ times through the medium of return and amortization allowance during the remaining $24\frac{1}{2}$ years of the life of the property. Isn't that right?

A. What I propose is that the amount of \$182,000-odd should be included in the rate base so that the company will receive a fair return on that amount and an amount in addition to the fair annual return that will amortize the investment.

Q. And the effect of that is to allow over the remaining $24\frac{1}{2}$ years $21\frac{1}{2}$ times the \$182,626 which it has already [fol. 8646] recovered?

A. I said it had been charged to operating expenses.

Q. Well, is my statement true or false?

A. I see no relation—

Q. (Interposing) Can't you answer my question yes or no? Let's get that off the record, first.

A. I say it has been charged to operating expenses.

Q. Is my statement correct or is it not?

A. Well, if you add income to amortization, yes, and that is what you are doing.

Q. Well, that is what you are doing, is it not?

A. No, sir.

Q. What are you doing if you are not doing that?

A. You cannot find that in Exhibit 104.

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[fol. 8648] By Mr. Littman:

Q. Mr. Green, let us look at your annual allowances for amortization which appear in your Exhibit 104 in the pro forma statement. The calculation appears on page No. 6 of that exhibit, does it not? A. Yes, sir.

Q. You use a $24\frac{1}{2}$ -year term as the purported remaining life of this project, do you not?

A. That is correct.

Q. You are not personally assuming any responsibility for that period, are you? A. Yes, sir.

Q. Upon what do you base the $24\frac{1}{2}$ -year period?

A. I am advised that the Panhandle Eastern were using a $24\frac{1}{2}$ -year life of the field from the witnesses that they had and I am of the personal opinion that the expected

life of 24½ years is the proper amount, in my own judgment, that should be used in this calculation.

Q. As I understand your testimony, you are basing the term upon the testimony of others in this proceeding?

A. Yes, but if I had not agreed, I would not have used in these exhibits here 24½ years.

Q. You did not make any independent investigation of your own with respect to the remaining life of the gas supply available to the Michigan Gas Transmission Corporation?

A. Not personally, no. I have familiarized myself with the opinions of others, experts.

Q. In other words, you are basing your judgment upon the opinion of others who have testified in this proceeding? A. That is right.

Q. Now, in your opinion, should the term be based upon the life of the gas reserves now controlled and owned by Panhandle Eastern or should it be based upon the life of the gas fields in which Panhandle Eastern operates?

A. I would say the life of the fields provided the Panhandle Eastern Pipe Line Company will have an opportunity of acquiring that gas.

Q. In other words, if the life of these gas fields, to-wit, the Hugoton and Panhandle fields, should extend 10 or 20 years beyond the life of the presently-held reserves of Panhandle Eastern, it would be proper to use the life of the fields rather than the shorter life of the reserves now [fol. 8650] held. Is that correct?

A. If Panhandle Eastern will be able to acquire that gas.

Q. You mean assuming a market?

A. Assuming it will be able to buy it. Someone else might own that acreage and want to use it for their own pipe line. I do not know.

Q. Do you know of anyone who has testified in this proceeding who has said that the life of the Panhandle Eastern's reserves is 25 years?

A. I think Mr. Ralph Davis testified, did he not, or Mr. Biddison? Now, I have forgotten which.

Q. Well, Mr. Biddison based his testimony on the opinion of Mr. Davis.

A. Of Mr. Davis, that is right.

Q. Mr. Davis said that the reserves had a remaining life of "more than 25 years." Do you recall that testimony? A. Yes.

Q. I am going to read you some testimony that was given by Mr. Creveling, the President of Panhandle Eastern and now the President of Michigan Gas Transmission Corporation before the Securities and Exchange Commission in connection with their recent refinancing of Panhandle Eastern. I am reading from Pages 518 and 519 of the transcript of that proceeding.

Trial Examiner: What docket number?

Mr. Culton: It is the same docket number as the Order [fol. 8651] heretofore offered in evidence.

Mr. Littman: It is the proceeding which culminated in the findings and opinions of the Securities and Exchange Commission shown in Exhibit 147, File Nos. 59-33, 70-263, 70-371, 70-387, 70-430 and 70-431 in the matter of Columbia Gas & Electric Corporation, et al.

By Mr. Littman:

Q. (Reading)

"Q. Could you tell us to what extent, or what limitations there are in purchasing those properties to increase your reserve?

"A. That is rather a difficult question to answer, Mr. Selig.

"We are strengthening our reserves in more than one way. Not only are we acquiring some additional acreage which has not yet obtained the position of being subject to any great drilling programs, and we are also blocking acreage by trading as well as by acquisition, in order to have satisfactory drillings in the Hugoton Field.

"We have a program, I think, in our budget, as I recall the figure as \$40,000, and probably will have some such an item in our 1942 budget, although of course that has not been before the Board for approval, and we will

keep acquiring acreage and blocking acreage as our business judgment indicates we should.

Q. And that is in the same Hugoton area?

[fol. 8652] A. That is correct, but it is getting away from that part of it in which the production, the major part of the production is now coming.

Q. And could you tell us what limitations there would be in acquiring this extra acreage?

A. I could give you my thought on that matter. My thought is that we should acquire property, as much as 25 or 30 thousand acres of additional reserve within the next couple of years.

Q. Well, is there any limitation upon your opportunity to acquire that amount of acreage?

A. That is the reason, one of the reasons why we are doing it at this time, one, because the acreage is available now to the greatest extent anyone could figure we would need additional reserve, and, second, it is not in demand today by other existing or potential projects, and therefore it can be acquired on a more favorable basis.

Q. Mr. Creveling, if it would be your program to get a reserve to last for that 25 years, say for 35 years, would you be able to get it in that field?

A. I have no hesitancy at all in stating that it is my best judgment that we could, if you will accept my definition of the Hugoton area.

Q. Well, will you describe the limitations, boundaries of the Hugoton area?

[fol. 8653] A. If I had a map I could show you. Roughly it includes all southwestern Kansas, the Oklahoma Panhandle, particularly Texas County, and Sherman and Hansford Counties, Texas.

Have you heard of that testimony before the Securities and Exchange Commission before?

A. I just heard it.

Q. This is the first time. Do you want to change your opinion as to the term of years, Mr. Green? A. I do not.

Q. You still stand by the 24½ years, notwithstanding the testimony of Mr. Creveling, the President of both of these companies, who now says that he is acquiring additional acreage and can very readily extend the life of this project for 25 years from today?

A. Yes, if I had two experts and one says "30 years" and one says "24 1/2 years" and I had the authority and responsibility of fixing the rates on that company, I would use the lesser amount, the more conservative. If, in 5 or 10 years from now, you find that the field is going to last these 35 years, I would readjust my costs at that time.

[fol. 8654] Q. You know that Mr. Davis, the expert upon whom you say you relied, based his estimate of "more than 25 years" upon the presently-held reserves of Panhandle Eastern, do you not, and not upon the over-all life of the fields?

A. As I understood, it was on the presently-held and present rate of withdrawals.

Q. Well, you are mistaken about the latter part of that, Mr. Green. The record will show what he said, of course.

Well, what effect did you then give to the life of the fields as distinguished from the life of the presently-held reserves?

A. We are using here 24 1/2 years in this calculation.

Q. And you are going to stand by it in spite of anything that anyone tells you about it. Is that right?

A. I think, in the light of all the record and information coming to me, that is a conservative figure to use at this time.

Q. That is the trouble with it, isn't it, it is too conservative? A. No, I do not think so.

Q. The company, itself, uses an over-all figure of 33 years, does it not?

[fol. 8655] A. They are using at the present time, charging 3 percent of the plant account for depreciation.

Q. So the answer to my question is yes, is it not?

A. If that is straight line, it would be 33 1/2 years.

Q. Then you think the company is in error in so doing?

A. I so stated this morning.

Q. You think Mr. Creveling is in error, too?

A. I do not know what they are charging Panhandle. I am not familiar with their bookkeeping methods.

Q. Well, do you think Mr. Creveling is in error when he says he has no difficulty securing sufficient gas acreage to last another 35 years? A. He is entitled to his opinion.

Q. You do not agree with him in that regard, do you?

A. I am not disagreeing with Mr. Creveling, I am saying that, in my opinion, a conservative figure to use here at this time would be $24\frac{1}{2}$ years from June 30, 1941, in determining the rates that this company should charge.

Q. What do you think is the reasonable figure as distinguished from what you call "a conservative figure"?

A. I think that $24\frac{1}{2}$ years is a reasonable figure. I really think that, Mr. Littman, I am not just making conversation either.

Mr. Littman: I am going to a new subject.

Trial Examiner: Before you leave this, referring to your [fol. 8656] original cost rate base on Page 2 of Exhibit 104, your recommendation is that the annual charges be sufficient to retire the present value of \$12,779,802 in the $24\frac{1}{2}$ years. Is that right?

The Witness: That is correct.

Trial Examiner: Now, assuming that Mr. Creveling extended the service for 10 years beyond that, what is the rate base beginning the 25th year?

The Witness: And the company had earned and charged off the amounts as shown here?

Trial Examiner: Surely.

The Witness: I imagine the rate base would be pretty low at that time, Mr. Examiner.

Trial Examiner: Proceed when you are ready.

By Mr. Littman:

Q. You have used, as the amortization base, the original cost as adjusted by a trend factor to reflect the purported change in the value of the dollar between 1936 and June 30, 1941, is that correct? A. That is correct.

Q. Would your amortization base be any different if you had used Mr. Haberly's reproduction cost less observed depreciation?

[fol. 8657] A. On the long-term investment, you mean?

Q. Well, let's confine the matter to the long-term investment. A. Yes; that is correct.

Q. The long-term investment comprises—

A. (Interposing) The major portion of the property.

Q. In fact, substantially all of the property, doesn't it?

A. Yes, sir.

Q. In order that we have no mistake about that, the original cost new of the short-term investment is only \$54,000, isn't it? A. That is right.

Q. There might be some slight confusion from a strict reading of the record thus far, Mr. Green, and I think I had better go over one point again in order that we may make certain that we understand each other.

Am I correct in understanding that your amortization base is the same as reproduction cost new less observed depreciation?

A. The dollar amount would be the same.

Q. By your method you are, of course, proposing to return to Panhandle Eastern, the present owner of Michigan Gas, something in excess of its net investment in Michigan Gas?

A. The amount which is determined by use of the formula which I have heretofore discussed in my direct testimony [fol. 8658] money gives you an amount in today's dollars that should be returned to the investor for the original dollars invested.

Q. So that by your method, the amount which you propose to return to Panhandle Eastern Pipe Line Company, the owner of Michigan Gas, over the remaining 24½ years of the purported life of this project will be something in excess of Panhandle Eastern's actual investment therein, isn't that correct?

A. Panhandle Eastern's investment, you say?

Q. Yes.

A. Of course, that investment was made in today's dollars.

Q. Precisely.

A. Yes. What I have determined here is the dollars when spent by the prior owners, how many today's dollars should you give back to the investor for his original dollars invested.

Q. But Panhandle Eastern, the present owner of this property, did not invest any 1936 dollars in this project, did it? A. No, that is correct.

Q. Do you mean that Columbia Gas & Electric Corporation, the former owner of Michigan Gas, still has some money coming from this project?

A. No, I do not and I do not think that if Panhandle Eastern had paid twice the amount that they did pay for this property, that that amount should have no bearing [fol. 8659] on determining the amount of amortization that I have used in this formula.

Q. Panhandle Eastern Pipe Line Company purchased Michigan Gas three weeks ago, did it not? A. Yes, sir.

Q. And it purchased Michigan Gas with 1942 American dollars, did it not? A. That is right.

Q. What you are proposing to do is to amortize, not the amount which Panhandle Eastern has invested in Michigan Gas in 1942, but something in excess of that which represents the purported revaluation of the property as represented by 1936 dollars, is that right?

A. In my familiarity with rate cases over a period of many years, to my knowledge I have never known of a case where the purchase price of a property was the rate base, that it was taken as the rate base.

Q. Will you answer my question, please, Mr. Green?

The Witness: Read the question.

(Whereupon, the question commencing at Line 10 of this page was read by the reporter.)

The Witness: I answered the question a moment ago of how we used this formula and why it was used.

[fol. 8660] By Mr. Littman:

Q. Is your answer to my question yes or no?

A. I cannot answer it by saying yes or no.

Q. It looks like we are going to have to ask you to make a calculation then. What is the original cost of the amortization base that you used in dollars and cents?

A. Less the observed depreciation, Mr. Littman?

Q. That is the base you used before you began to apply the factor.

A. Original cost less observed depreciation less the short-term property?

Q. Yes, what that is.

A. \$11,911,979 as shown on Page 6 of Exhibit 104.

Q. \$11,911,979? A. Correct.

Q. Will you state the amount which you are amortizing?

A. \$13,819,001, which is arrived at by dividing \$11,911,979—

Q. (Interposing) Just a minute. I am going to ask you to cooperate and not read the factor which you applied because the factor has been stricken from evidence.

Mr. Baldridge: I do not think you could say that, Mr. Littman. Exhibit 97 has been excluded but I do not think the specific factor has been excluded.

Mr. Littman: Well, certainly we have not withdrawn any [fol. 8661] of our objections to Exhibit 104. Exhibit 104 is not yet admitted in evidence and is still subject to a motion to strike and I think, out of precaution, we should not have read into the record at this point figures that you well know will be subject to a motion to strike.

By Mr. Littman:

Q. In other words, you are amortizing \$1,907,022 more than the original investment in this property, aren't you?

A. That is correct.

Q. Panhandle Eastern Pipe Line Company did not pay the \$13,819,001 that you are now amortizing, did they?

A. They did not.

Q. As a matter of fact, they did not even pay the \$11,911,979 either, did they, but something less than that?

A. That is correct, I think.

Q. Will you state for us the net investment by Panhandle Eastern in this property which you propose to amortize?

A. I do not know what that figure is, Mr. Littman.

Q. I am sorry.

A. I do not know that figure but I think it is in the record here. I think you put it in the record by asking questions of Mr. Spitznagle.

Q. It is something less than \$11,911,000, isn't it?

A. Yes, it is.

Q. The depreciation reserve at July 1, 1941, was \$1,526,604, wasn't it? A. That is correct.

[fol. 8662] Q. Referring to Exhibit No. 104, Page 6, I see a total in the right-hand column at about the center of the page of \$14,219,687 which is labeled "Total investment recoverable through amortization". Do you find that figure? A. Yes, sir.

Q. That is the total amount which you are amortizing in this exhibit? A. That is correct.

Q. For purposes of this proceeding, is it not?

A. That is right.

Q. Now, you have already stated that the depreciation reserve at July 1, 1941, of Michigan Gas was \$1,526,601, have you not? A. Yes, sir.

Q. Now, that amount has been already amortized and recouped by the company to July 1, 1941, is that right?

A. That is the amount that is in their reserve account.

Q. Now, adding that to the amount which you propose to amortize gives a total recovery from the beginning of the life of the property to the purported end of the life of the property of \$15,746,335, isn't that correct?

A. \$14,219,687 plus that amount would equal the sum you mentioned.

[fol. 8663] Q. The actual gross investment in this property was \$12,207,261, isn't that right, as shown on Page 6 of Exhibit No. 104? A. That is correct.

Q. The difference between the \$12,207,261 of actual investment and the total of \$15,746,335 which has been amortized and which you propose to amortize is \$3,539,074, is that correct?

A. Your mathematics, I imagine, are correct.

Q. Yes, so that over the life of this property, if your method is adopted, the owners of Michigan Gas will have recovered, by way of amortization, \$3,539,074 in excess of the actual investment therein, assuming the correctness of my arithmetic?

A. By such a process of arithmetic, Mr. Littman, you are confusing dollars spent in 1936 and dollars that we are speaking of here in 1941.

Q. Aside from that element—

A. (Interposing) That has no relation to this exhibit the way we have set it up here.

Q. Mr. Green, eliminating the element of the change in the valuation of the dollars from year to year, your answer to my question would be yes, wouldn't it?

A. If there had been no change in the valuation of the dollar, that would not be the case, no. We would not have [fol. 8664] had it. Instead of dividing by .862, the factor would have been 1.

Q. If we had not had a change—

A. (Interposing) In the purchasing power of the dollar.

Mr. Littman: I am going to ask that the .862 reference be excluded. My question did not call for it and, as your Honor knows, it is subject to objection.

Trial Examiner: I think the figure should be excluded from the record.

Mr. Baldridge: May I have an exception?

Trial Examiner: You may.

May I ask a question? I do not recall whether the testimony shows the actual excess of the total to be recovered by amortization, namely, approximately \$15,000,000 over the price paid by Panhandle Eastern Pipe Line Company to Columbia for the property recently. Was that figure stated?

Mr. Littman: The \$12,207,261 figure which I read gives effect to the purchase and reflects the total original investment in the plant and property of Michigan Gas.

Trial Examiner: But this inquiry was with reference to the comparison between the amount, in toto, to be amortized.

Mr. Littman: From the beginning.

Trial Examiner: To be recovered by amortization as compared with the recent purchase price of the property. What was the excess, was that stated?

[fol. 8665] Mr. Littman: Yes, I stated the excess to be \$3,539,074.

Trial Examiner: And that is the difference between the total recovery by amortization and the price paid to Columbia?

Mr. Littman: That is right, yes, sir.

Trial Examiner: Thank you.

Mr. Littman: I wanted, however, to get the witness to agree with just that, if your Honor please, which is our understanding.

Do you agree with our understanding that the \$3,539,074 represents the excess amount of amortization which you are providing for and which has been recovered by Michigan Gas over the entire life of the property over and above the actual investment in that property?

The Witness: The mathematics which you give are correct but it is my understanding that we begin the rate making when the Natural Gas Act came into existence. We want to start off from that date.

Trial Examiner: That is a legal question, Mr. Green, that you do not need to deal with.

By Mr. Littman:

Q. You see, I am merely trying to get at the fact through the medium of the dollars. I am taking your provision for amortization, that is, your amortization base, and I am adding to that the amount of depreciation reserves that have been accumulated to June 30, 1941, at [fol. 8666] which time you commenced to carry on.

I am asking you whether the total of those two items does not represent an excess of \$3,539,074 over and above the actual gross investment in Michigan Gas?

A. That is correct, yes. I have said so several times.

Q. Mr. Green, I do not think the record showed that you answered my question directly. I am sorry if I have taken up a great deal of time needlessly but I wanted to be clear on that.

A. I do not know whether there have been any charges, Mr. Littman, against this reserve account. There might have been. There might have been more charged for depreciation. I do not know. You have got the net.

Q. Taking the books as we find them—

A. (Interposing) You are using the net.

Q. In your opinion, is Panhandle Eastern Pipe Line Company entitled to an excess of amortization of \$3,539,074 over that which represents the amount which it paid for this property in 1942 dollars?

A. I have clearly explained, I think, how I made this calculation. Now, the Examiner tells me I should not be giving legal opinions, so—

Mr. Baldrige: (Interposing) I think, Mr. Examiner, now the question is put to him in that form, the witness would have the right to answer the question.

[fol. 8667] By Mr. Littman:

Q. Do you think that is a fair thing to do?

A. I think that the owners of this property should have the amounts that I set forth in Exhibit 104 earned in order for them to receive a fair return on the fair value of their property.

Trial Examiner: We are, however, Mr. Green, trying to arrive at the rate base of original cost.

The Witness: We have determined that or at least gave in an exhibit here what we considered the original cost rate base and that we have used throughout these calculations.

Trial Examiner: You used the term "fair value."

The Witness: No, I meant this whole exhibit. I assume that we are to try and determine the annual revenues of this company which will provide a fair return on the fair value of the property.

By Mr. Littman:

Q. Mr. Green, will you please refer to Exhibit 105 and I shan't read the title. It is very lengthy and I believe the context of my questions will elicit the nature of the exhibit.

A. I have it.

Q. In this exhibit, you make a calculation to ascertain the amount of Federal income tax and excess profits taxes that would be paid under what you call a "proposed capitalization." Is that correct?

[fol. 8668] A. Yes, sir.

Q. What is this so-called proposed capitalization?

A. 50 percent bonds and 50 percent common stock.

Q. You mean 50 percent of 3½ percent serial debentures due in 16 equal annual installments, is that correct?

A. That is correct.

Q. Who has proposed such a capitalization for Michigan Gas?

A. I had this calculation made on the assumption that if this company was sold to the public, in my opinion that

would be a sound capitalization, 50 percent bonds and 50 percent common stock.

Q. You call this a "proposed capitalization"?

A. Yes.

Q. And I am asking you who has proposed it?

A. I did. I say I proposed it.

Q. Do you expect anybody to act on that?

A. No, because the property was not sold to the public. It was sold to Panhandle Eastern and they acquired the securities and it is very much to their advantage to continue to operate this company as a subsidiary with the present capitalization.

Q. In the light of events that have transpired since you prepared this exhibit, No. 105, the exhibit is passe, is [fol. 8669] it not?

A. Not at all.

Q. Isn't this purely a hypothetical exhibit?

A. Yes, the company has not been refinanced and its securities sold to the public. That is the assumption here.

Q. Has anyone connected with Panhandle Eastern or Michigan Gas made any such suggested capitalization?

A. No, the purpose of this exhibit, I think, if you refer to my direct testimony, was to show that the Federal taxes of this company are much lower than they would be if the company was sold to the public.

Now that it is a subsidiary of Panhandle Eastern, you had better throw them all together and make a consolidated statement. We have not used this figure in any of our calculations, you understand that.

Q. Yes, I understand that and that is why I wondered why you put the exhibit in in the first place and I wanted to know what use it was intended to be put.

A. Well, it was to show this, Mr. Littman, that if this company, as long as it is a wholly-owned subsidiary of a holding company,—it was Columbia Gas and Oil was it?

Mr. Baldridge: Columbia Gas & Electric.

The Witness: Now, it is a wholly-owned subsidiary of Panhandle Eastern, but if you take this company by itself now to determine rates, its Federal taxes are not comparable to what they would be if the securities were sold to the public.

By Mr. Littman:

Q. Panhandle Eastern can, at its own discretion, consolidate and merge Michigan Gas, according to whether there is an advantage to such consolidation and merger after considering the tax situation, isn't that correct?

A. Yes, I do not think they will because it is to their distinct advantage to leave it as it is because they save Federal taxes.

Q. The company in computing Federal income taxes and excess profits taxes would, of course, compute them on the basis of the presently existing facts, would it not?

A. I think so. This was put in here merely for the benefit of the Commission.

Q. For illustrative purposes?

A. That is right. Here we are giving an income statement of a company, what it should be, its revenues and expenses, and yet there is an item of taxes in here which we know is out of line. You see.

Q. Which tax is out of line?

A. I mean the Federal taxes are lower than they would be with a company whose securities were in the hands of the public.

Q. Which one of these two tax figures is out of line, the one that is being paid now or the one that would be [fol. 8671] paid under this proposed capitalization?

A. Well, the amount being paid by the company today is less than it would be if the securities were sold to the public. This is merely informative only, Mr. Littman.

Q. And presents a situation which does not obtain today?

A. That is correct.

Q. And so far as you know will never obtain?

A. I do not know, I do not know.

Q. You do not have any reason to believe that it ever will obtain, do you?

A. I do not know, Mr. Littman.

Q. Neither do we.

Mr. Chamberlain: Mr. Green, how is the return affected by its being a subsidiary or holding company?

The Witness: I do not believe you could sell the amount of debentures that this company has outstanding to the public. The ratio of that debt to the total property is way

out of line, but you get a distinct saving in your Federal taxes.

Mr. Chamberlain: What is the saving?

The Witness: What?

Mr. Chamberlain: What is the saving, that is what I want to know.

The Witness: In amount of dollars?

Mr. Chamberlain: Yes. How is it affected in so far as these tax returns are concerned by being a subsidiary?

[fol. 8672] The Witness: The fact that its capitalization is different than it would be if you sold to the public.

Mr. Chamberlain: You mean it might change its form of capitalization or structure in some way?

The Witness: I think it would have to change its form of capitalization if it was going to sell to the public. I certainly know that the Securities and Exchange Commission would not let you issue such amount of securities against this company, outstanding debentures on open account, you know.

Mr. Chamberlain: Are you talking about Michigan Gas Transmission?

The Witness: Yes, sir.

By Mr. Littman:

Q. Will the Securities and Exchange Commission permit you to issue any securities on this amount which represents the difference in your rate base between the valuation of the dollar today and the valuation of the dollar in 1936?

A. I thought we were talking about taxes here.

Q. I know, but this is apropos here at this moment to your rate base.

Trial Examiner: Isn't the gold content of a dollar the same as it was in 1936?

By Mr. Littman:

Q. You are an expert in the change of the valuation of the dollar, Mr. Green. Can you answer that question?

[fol. 8673] A. Not now, I have had some experience—

Mr. Goodman: (Interposing) I think the Examiner means the price on newly-mined gold.)

Trial Examiner: Unless we know something about it, I do not think we should refer to the different value of the dollar between 1936 and today. It is not in evidence anyhow. There has been some evidence offered here which has been excluded relative to the purchasing power of the dollar between those periods.

Mr. Baldrige: The evidence on the question of the purchasing power of the dollar runs all through the record. It was brought out by various counsel and was testified to by various witnesses. I do not believe it would be proper to exclude that in a hearing of this kind because, obviously, there are many things that the purchasing power of the dollar and the change in the purchasing power of the dollar may touch and affect. It may touch and affect the necessity for making additions to property.

Trial Examiner: I agree with you, Mr. Baldrige. We have in the record, without objection, some data indicating the change in the purchasing power of the dollar but the value of the dollar, technically speaking, I assume to be the same in 1936 as it is today.

Mr. Baldrige: Well, I do not believe that anybody on our side, at least, has raised any question of the gold content of the dollar. I think that all of our discussion has been on the question of varying purchasing power. That is, if I may use this expression, the value of the dollar as weighed by what a dollar will purchase at different times.

Trial Examiner: That is, of course, the sense in which we have used it.

Mr. Baldrige: Yes.

Trial Examiner: Perhaps it is a bit loose.

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By Mr. Littman:

Q. Mr. Green, you have not, thus far, in this proceeding expressed any opinion on the fair rate of return for Michigan Gas Transmission Corporation, have you?

A. I have not. I had better qualify that. You remember at the close of my direct statement I spoke of the present earnings of the company and so forth, but I did not give any percent return that I thought would be a fair return.

Q. You are not testifying on that subject, are you?

A. As to the percent return, no.

Q. You use a 6½ percent return in your Exhibit No. 104 as shown on Page No. 2 but, as I understand it, that rate of return is used for illustrative purposes because the Federal Power Commission used the 6½ percent rate [fol. 8675] of return in the Natural Gas Pipeline of America case. Is not that right?

A. Yes, with a rate base of reproduction cost new.

Q. For interim order purposes?

A. That is correct.

Q. Let's not forget that. Hence, we shall not cross-examine you on what is the fair rate of return.

At Page 2003 of the transcript you make the following statement:

"To use a homely illustration, if a person invests his money in a public utility and the company constructs property today for the public use, he is entitled to receive a fair return on his investment and that investment is equivalent to a certain amount of bacon and eggs. Each year thereafter he is entitled to receive the same amount of bacon and eggs, regardless of the purchasing power of the dollar."

You recall that testimony; do you not, Mr. Green?

A. I believe you must have made a mistake in quoting me, because you speak of investment whereas I am speaking of return, that the return will purchase a certain amount of bacon and eggs.

Mr. Littman: Will you please read the quotation back to the witness and have him check from the transcript?

The Witness: This is correct. Perhaps I misunderstood you, Mr. Littman, and that fair return is equivalent [fol. 8676] to a certain amount of bacon and eggs. I un-

derstood you to read it, "that investment is equivalent to a certain amount of bacon and eggs".

Q. What is the present capitalization of Michigan Gas?

A. As of June 30, 1941, 6 percent demand notes, \$5,900,500; 6 percent loans payable to the parent company, \$2,420,000 and 44,800 shares of no-par value common stock with a stated value of \$2,240,000.

Q. The capitalization today is the same as it was prior to the sale of Michigan Gas to Panhandle Eastern, is it not, in so far as you know?

A. Well, I imagine there would be very little change, Mr. Littman. I do not know whether they have borrowed any money from the parent since this date or not, June 30, 1941.

Q. Will you please turn to Page 2 of Exhibit 88 which is the balance sheet? It is clear from the figures which you have read that 80 percent approximately of the capital structure of Michigan Gas is represented by these 6 percent notes?

A. Yes, sir.

Q. How much of the capital originally invested in 1936 was secured by these notes, as shown on Page 2 of Exhibit 88?

A. What was your question now?

Q. How much of the capital originally invested in 1936 in Michigan Gas was secured by these notes?

[Vol. 8677] A. In 1936 this statement shows as at December 31, \$5,136,397.68 is the 6 percent loans payable.

Q. How much of the capitalization at December 31, 1937, was represented by 6 percent demand notes?

A. \$6,391,094.30.

Mr. Baldrige: Mr. Littman, I am getting a little confused. You are treating with demand notes and 6 percent loans payable as being the same kind of thing?

Mr. Littman: I called them by the description used on Page 2 of Exhibit No. 88.

The Witness: I think that is correct, Mr. Littman. As of the end of the year they had no loans payable. They were all made in demand notes payable.

By Mr. Littman:

Q. Now, the common stock has remained constant throughout the life of the property?

A. Yes, sir.

Q. Now, those 6 percent demand notes that were outstanding in 1937 in the amount of \$6,391,094 still remained unpaid at June 30, 1941, is that correct?

A. The 6 percent demand notes payable as of June 30, 1941, were \$5,900,500 which is less than the demand notes payable December 1937.

Q. I see. In other words, there was still outstanding at June 30, 1941, \$5,900,500 of the demand notes that had [fol. 8678] been outstanding in 1937. Is that right?

A. That is correct.

Q. Now, Panhandle Eastern Pipe Line Company has within the past three or four weeks acquired these 6 percent demand notes, is not that correct?

A. I understand so.

Q. And now Michigan Gas owes \$5,900,500 of 6 percent demand notes to Panhandle Eastern. Is that right?

A. I assume that they do, yes.

Q. Now, is the holder of these notes, namely, Panhandle Eastern, entitled to receive payment therefor in anything other than present-day dollars?

A. No, I do not think so.

Q. In other words, you understand that under the law of these United States, if Michigan Gas Transmission Corporation were to tender to Panhandle Eastern the amount of \$5,900,500 in United States currency today, Panhandle Eastern would be required to accept those dollars in full payment of those notes notwithstanding the fact that they were originally made in 1937. Is not that right?

A. I would think so.

Q. As a matter of fact, the entire amount of \$8,326,500 of 6 percent demand notes and loans owing today to Panhandle Eastern are payable in 1942 dollars. Is not that right?

[fol. 8679] A. That is correct.

Q. And the interest on these notes and loans is payable each year in present-day dollars regardless of how many bacon and eggs those dollars will buy?

A. That is correct.

Q. What kind of dollars did Panhandle Eastern pay for these outstanding securities of Michigan Gas Transmission Corporation, 1942 dollars or some other kind of dollars?

A. I assume that they used 1942 dollars.

Q. Did Columbia Gas & Electric Corporation make any protest against receiving 1942 dollars in payment in full of the purchase price of all of the outstanding securities of Michigan Gas?

A. No. Such sales and negotiations are always carried on, I think, with the understanding that you pay in today's dollars.

Q. What you are proposing to do is to suggest that the Federal Power Commission predicate the rates in question in this proceeding, not upon the basis of present-day dollars, but upon the change in the purchasing power of the dollar that has ensued since 1936?

A. In determining the rate of return.

Q. And also in determining the amortization base?

A. That is correct.

Q. The effect of your bacon and eggs theory, Mr. Green, [fol. 8680] is to give the investor in this utility's securities, a complete safeguard against inflation, isn't that right?

A. That is right, it has that effect.

Q. Do you know of any security extant that carries with it a safeguard against inflation?

A. If I may be permitted to express my opinion as to what the Act means, a fair regulation meaning a fair return on the fair value of the property, I think this formula I have set up here will apply.

Q. Suppose you name one security extant that guarantees the repayment of the principal in terms of the purchasing power of the dollar as of the date in which the investment was made and which guarantees against inflation?

A. That is not the case. The formula I used here in determining the amount of dollars to amortize this investment is only applied once, Mr. Littman. Later on, you can have inflation or anything else and it will not affect that dollar amount that I use here for amortization.

Changing the purchasing power of the dollar was only used to determine the number of dollars as of June 30, 1941, that the investor should receive equivalent to the dollars that he spent in the prior years.

Now, if later on, the purchasing power of the dollar changes, you will not change that amount that we have determined here for amortization even though the purchasing [fol. 8681] power of the dollar changes.

Mr. Lee: You may not change the amount but, according to your theory, you would have to change the return?

The Witness: You would the return. I am speaking now of amortization. If the purchasing power of the dollar changes under the formula I have suggested, the percent return will vary. The fair rate of return today divided by the purchasing power of the dollar factor equals the percent return that this property should receive. That will change but not the amortization calculation.

Mr. Lee: That is now, according to your theory?

The Witness: That is right.

By Mr. Littman:

Q. I thought Mr. Drew was your witness on the question of the correct and proper rate of return to be applied in this proceeding. Is my understanding incorrect?

A. He was asked to give an opinion of what he thought a company of this sort should receive in percent return.

Q. Did you ask him to testify to the rate of return on an inflation-free investment?

A. No, I did not.

Q. That is what this would be, wouldn't it, under your theory?

A. Are you speaking now of return or are we talking about the amount to amortize, Mr. Littman?

[fol. 8682] Q. We are speaking of return exclusively.

A. Return?

Q. Yes.

A. I claim and the suggestion I have made here in the formula I have given the Commission to use is that we use the purchasing power of the dollar as one factor and the fair rate of return in today's dollars to arrive at the percent return that this investment should receive.

Q. When you asked Mr. Drew to testify in this proceeding, did you instruct him to give us a rate of return which comprehended and gave effect to a guarantee against inflation?

A. No.

Q. You know if you had instructed him to do that, he would have most certainly testified to a considerably lower rate of return than that to which he testified in this case, don't you?

A. I do not know what he would have testified to if I had asked him to do something [to do something] I did not ask him to do.

Q. Would you, as an investor, be willing to accept a lesser rate of return if you were guaranteed against inflation than otherwise?

A. And also if I was guaranteed a return?

Q. Would you require any return at all if you could get a good, safe guarantee against inflation today? You would [fol. 3583] be glad to invest your money without any return if you could get that kind of a guarantee, wouldn't you, Mr. Green?

A. I would not be much interested in investing my money without any return, Mr. Littman, no.

Q. It would certainly be considerably lower than 8½ percent, wouldn't it, if you could get a good inflationary hedge guarantee?

A. I have not fixed any 8½ percent.

Q. Can you advise me where I can find a security that will guarantee me against inflation even if it does not have any return at all?

A. No, I do not.

Q. I wish you could.

A. I do not know where you could be guaranteed anything.

Mr. Goodman: Maybe you know where I can buy some bacon and egg futures to protect me.

By Mr. Littman:

Q. Mr. Green, the Government itself makes no such guarantee upon its bonds, does it?

A. Why, a bond, that is a contract between the Government and some person who wants to make an investment.

The terms are set forth. Here you have an entirely different problem. We are speaking here about a fair return on the fair value of the property invested in the business, a regulated business.

[fol. 8684] Q. We want to get your opinion on the subject of a fair return on an inflationary-free investment. That is, an investment free from inflation.

A. My whole thesis here is that if you are going, on the one hand, to use original cost as a fixed item as the rate base, if you are going to use that, then you must vary the percent return to reflect the purchasing power of the dollar.

Q. Then, as I understand your theory, we must find a reasonable rate of return applicable and referable to original cost, must we?

A. No.

Q. Before we apply your factor to get what you call a reasonable return?

A. No, that is not the way this is applied.

Q. That is the way you applied it in Exhibit No. 104?

A. No, I did not.

Q. You took 6½ percent which the Commission found—

A. (Interposing). As a fair rate of return in today's dollars as related to reproduction new of that property. No, I am saying if you used that figure, 6½ percent—

Q. (Interposing). Is that 6½ percent a fair return upon an inflation-free investment?

A. The 6½ percent against the reproduction new of the Natural Gas Pipeline of America case was held by the Commission to be a fair return. I am saying that if you [fol. 8685] are going to use original cost as the rate base, then take your 6½ percent, divide it by the purchasing power of the dollar factor and you get an amount which you relate to the percent return on original cost.

You refer constantly to inflation. This formula, with deflation, call it that, would work just the other way.

Q. We understand how your theory works, Mr. Green.

A. But it works both ways, doesn't it, not just with inflation.

Q. I understand you to say that, yes.

A. Yes.

Q. You have never applied it, however, in any case that arose during the midst of the depression, did you?

A. I do not suppose I can refer to the exhibits. I can say this—

Q. (Interposing) Did you or didn't you?

A. I can say that during the past several years, the cost of pipe was considerably less than they paid for other pipe on this property.

Q. Have you ever applied this bacon and eggs theory at a period when the purchasing power of the dollar was rising?

A. No, I have not.

Q. We would like to know how to apply your theory, Mr. Green. Your factor has to be applied to a certain rate of return, does it not, in order to get what you call a reasonable rate?

A. Take return in today's dollars of what is held to be a fair return. That divided by the purchasing power of the dollar factor equals a percent return which I think this property should [—] received based on original cost.

Q. Will you tell us what is a fair return upon an inflation-free investment, and then I think we can apply your theory.

A. I cannot answer that. It is beside the point here.

Q. How is the Commission going to know if you don't know?

A. You can use this formula and if the purchasing power of the dollar goes the other way, you come out with a lesser percent return.

Q. What are we going to apply this formula to?

A. To the original cost as a rate base.

Q. How are we going to get the rate of return which you say is reasonably applicable to original cost?

A. Only by this formula.

Q. We have got to have a rate of return which must be divided by your factor to get what you call a reasonable rate of return. How are we going to get the first one?

A. The Commission fixed one in the Natural Gas Pipeline of America case, didn't they? It fixed it there, 6½ percent.

Q. But that was not on an inflation-free rate base?

[fol. 8687] A. That was on the dollars—whatever the case was decided—those dollars on reproduction cost which

naturally reflect the difference in the purchasing power of the dollar using that as the rate base.

Q. Mr. Green, until you advise us what is a reasonable return on an inflation-free rate base, we cannot apply your theory, can we?

A. I am stating that if the Commission finds a percent return which they consider a fair return on property constructed today, which means today's dollars, take that percent, apply it to this formula and you may derive the percent return that this investment should receive. Certainly no one would say that $6\frac{1}{2}$ percent return they used in the Natural Gas Pipeline of America case, $6\frac{1}{2}$ percent on original cost would be a proper amount for that company to earn. If so, why did they allow $6\frac{1}{2}$ percent on reproduction cost which was considerably higher?

Q. Mr. Green, the first step that the Commission must do under your theory is to determine what is a reasonable return upon the reproduction cost of the property today guaranteed against inflation in the future. Isn't that right?

A. No, I do not think so.

Q. You are guaranteeing the investor against inflation, aren't you, when you apply your factor as you said a minute ago?

A. Let's put it the other way. The same formula, if [fol. 8688] conditions change, protects the consumer in the case of deflation.

Q. Suppose you answer my question, Mr. Green.

A. I have answered it.

Q. I submit you have not. You are, in effect, providing a guarantee against inflation in the future, are you not, by your method?

A. If the purchasing power of the dollar goes that way, this formula protects the investor, yes.

Q. Now, in order to apply your formula, we first must find what is a reasonable rate of return to an inflation-free rate base, must we not?

A. No, sir, you first find out what is the percent return that a utility should receive for property built today and then apply that percentage in this formula.

Q. If the Commission were to follow your theory, it is a fact, is it not, Mr. Green, that we would have the only securities extant that carried with them a guarantee against inflation. Isn't that right?

A. If the investor is entitled to a fair return on the fair value of his property, it is my judgment that that formula if applied and I have tried to explain it in detail, would give him a fair return on the fair value of this property.

Q. And would give him a hedge against inflation, wouldn't it?

[fol. 8689] A. And if the purchasing power of the dollar—

Q. (Interposing) Would it or wouldn't it?

A. Only if the purchasing power of the dollar went that way, Mr. Littman. Now, if it went the other way, it is protection to the rate payer, we will call it, in the event of deflation.

Q. If there is inflation in the future, your theory affords to the investor a hedge against that inflation, does it not?

A. If the purchasing power of the dollar in the future, as applied to this sort of property in this territory is constructed decreases greater than the amount that it is today then the percent return would be higher.

Q. Now, regardless of what happens to the dollar today, tomorrow or in the future, you are guaranteeing to the investor that he will not be hurt by any inflation that may ensue, are you not?

A. This is a great assistance to the investor in case of inflation, yes, sir, it is.

Q. And would he accomplish that purpose, if this Commission were to adopt your method, we would have the first, one and only security extant that carried such a guarantee, would he not?

A. Well, in the past, we have had—

Q. (Interposing) Wouldn't he?

[fol. 8690] A. Many rate cases and decisions of the Courts and what not have used reproduction cost new as a rate base and that takes into account the purchasing power of the dollar.

Q. Can you imagine, Mr. Green, what kind of a scramble and rush there would be by investors to buy these inflation-free investments that you suggest? They would be preferred, would they not, to the Government bonds?

A. Well, during the past—

Q. (Interposing) Can't you answer that question yes or no?

A. Just a moment. I can answer it, yes. During the past when reproduction new was used as the rate base I did not see any great scramble to buy the securities.

Q. Mr. Green, reproduction cost is not synonymous with fair value and never has been, has it? Even under Smythe versus Am. it never has been, has it?

A. It is a factor that was used in determining the fair value of the property. Reproduction cost new was a factor which was given considerable weight.

Q. No court ever said that it guaranteed to the investor a fair return upon reproduction cost and that alone through the years?

A. No, indeed, I agree with you, but reproduction cost new in determining the rate base was a factor that was used by the Commission and courts and given, as I recall, [fol. 8691] call, considerable weight.

Q. Mr. Green, what do you imagine would happen if the prospectus, which is in evidence as Exhibit No. 146, if this prospectus issued by Panhandle Eastern Pipe Line Company within the past month carried on its face a guarantee to the investors in Panhandle Eastern of a return upon an inflation-free investment? What do you imagine would happen?

A. I could not give any answer to a question like that, Mr. Littman.

Q. Would Panhandle Eastern Pipe Line Company have to pay anything like 3½ percent on its bonds or 3 percent on its bonds, rather?

A. I do not know, I could not answer that.

Q. Why, they might even charge the investor 3 percent as a price for the inflationary hedge, might they not?

A. What we are determining here is a ceiling, not a [guarantee]. The company has not guaranteed a dime of revenue, not a dime. In fact, in this particular company, —a transmission pipe-line company I think is a very hazardous business.

Q. I have an insurance policy, Mr. Green, which does not guarantee that my beneficiaries shall be paid in anything but United States currency as of the date of my death. Can you advise me where I can buy an insurance policy that will guarantee me against inflation?

A. Well, that was a contract that you made with the [fol. 8692] insurance company, was it not, sir?

Q. I would like to make a contract hedging against inflation. Can you refer me to anyone that would give me that kind of a contract?

A. Mr. Litman, if the Commission should adopt the formula that I am setting up here, I am not saying that that is any guarantee against inflation.

Q. What you are asking the Commission to do here is to give Michigan Gas Transmission Corporation a contract against inflation, aren't you?

A. No, sir.

Q. What you are asking the Federal Power Commission to do is to protect the investors in Michigan Gas Transmission Corporation against inflation, aren't you?

A. I think as the purchasing power of the dollar changes and you are going to use original cost as the rate base, that you must have some method of varying the percent return.

Q. Now, Mr. Green, you have suggested a method by which we may protect the investors in Michigan Gas Transmission against inflation. Will you please suggest a method whereby the Federal Power Commission can protect the consumers or the customers, if you please, against inflation? What is fair, I presume, for the investor is fair for the consumer.

A. Do you understand in the application of this formula that as the purchasing power of the dollar goes down or, rather, goes up, that you would be lowering the rates under this formula, you would lower the rates to the consumer as against using the straight original cost as a rate base?

Q. Mr. Green, I do not understand your theory nor do I understand how it can be applied and I am asking you to explain how you may apply it in practice. Now, you have got the investor protected against inflation here by your method, haven't you?

Now, will you tell me what you are going to do for the consumer to protect him? What would you suggest?

A. I am stating that if the purchasing power of the dollar, I will say, becomes the factor, becomes 116, ap-

plied to this formula, the over-all earnings of this company will be less than if you used original cost as the rate base.

Q. Well, you cannot sell me this merely by pointing out that it might produce lower rates some day in the future. I would like to know about the validity of the theory regardless of—

A. (Interposing) It is based entirely upon the purchasing power of the dollar. As it varies, the percent return varies.

Mr. Lee: Rather, isn't your argument a perpetual argument for the reproduction theory as a rate base? That is what you are really striving after, all the time, aren't you?

[fol. 8694] The Witness: No, heretofore the rate base was a variable in all of these rate cases. That was the variable in the percent return as fixed.

Now, I am stating that if you are going to have the rate base to be fixed, in other words, original cost, I think that you have to vary the percent return and I have offered this in my humble way as some formula that would bring that about.

Mr. Lee: Because you are sold on the theory that the rate base should be the reproduction cost?

The Witness: No, I do not think much of that scheme because it is so difficult to determine reproduction cost. It is a difficult thing to do.

Mr. Lee: The rate base, if it were the reproduction cost, would always take care of the variation in the purchasing power of the dollar in the interval between the original expenditure and the fixing of the rate.

The Witness: It is supposed to do that, that is the theory.

Mr. Lee: So in the last analysis that is what you are always contending for, the reproduction cost as the rate base, aren't you?

The Witness: No, I am saying that under that theory it is supposed to take care of it, Mr. Lee, but I say, I think

personally, that it is a very difficult thing to determine from time to time.

[fol. 8695] Trial Examiner: The figures that you are reading were adjusted by the use of an index figure obtained as the result of certain fluctuations specifically, I believe, affecting the cost of about six special articles of manufacture. Is that a sound basis for determining the purchasing power of the dollar when you approach the rate problem?

The Witness: Well, that is the way Mr. Haberly developed it.

Trial Examiner: I am just asking you if you accept that as a sound approach.

The Witness: I say that is the way he developed it. Now, on my own initiative I made some investigation on the question of the purchasing power of the dollar and I referred to exhibits introduced by Dr. Friday in this case.

You take his curve that he shows, which is the Department of Labor curve, prepared by the Department of Labor on wages paid over the period of years. Another curve was steel products and I took the curves, 1936 and I took the point '41', 1941, on the curves and found the difference there and it is a rather unusual thing. It came out .86.

Trial Examiner: And that is in accord with your testimony?

The Witness: Yes, sir, and had nothing to do with this property, you understand. That was just taking the purchasing power over-all of all labor of the whole country. [fol. 8696] It came very close to Mr. Haberly's figures.

By Mr. Littman:

Q. Will you give me a yes or no answer to this question: In order to apply your theory we must first ascertain the proper rate of return applicable to an inflationary-free rate base, do we not?

A. No.

Q. To an inflationary-free investment?

A. No.

Q. Well, that is what these investors would have, wouldn't they, if your theory were adopted?

A. I do not think so, Mr. Littman, no.

Q. Well, you have been saying all along that you were going to give them a guarantee against inflation, haven't you?

A. I have not.

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[fol. 8703] Mr. Littman: Mr. Examiner, before I continue with my cross-examination of Mr. Drew, I would like to take up another matter in connection with Mr. Young's testimony. When Mr. Young was last on the stand, I requested him to supply further information and he advised me in writing under date of March 2, 1942, as follows:

"On February 28, 1942, as shown on page 8528 of the transcript of the proceedings before the Federal Power [fol. 8704] Commission, I testified that in the period between August 11, 1936 and February 5, 1942, a total of nine hundred and thirty-eight (938) draw-bands and two (2) collar leak clamps had been installed on the 16" pipe line formerly owned by the Ohio Fuel Gas Company, but operated and maintained by Michigan Gas Transmission Corporation. A subsequent and less hurried check of our records shows that a total of one thousand, one hundred and three (1,103) draw-bands and three (3) collar leak clamps have been installed by years as follows:

August 11, 1936 to December 31, 1936—43 draw-bands

Year 1937	—221
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1938	—203
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1939	—212
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1940	—177
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1941	—216
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January 1, 1942 to February 5, 1942	—11
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Total

1,103 draw-bands

September 3, 1937—1 collar leak clamp

August 26, 1938—1

May 3, 1940 —1

Total 3 collar leak clamps

As stated on page 8529 of the transcript, draw-bands were installed on the 6" lateral pipe line extending to Winchester from the 16" pipe line as follows:

[fol. 8705]	Year 1938—1 draw-band
	1939—3
	1940—3
	1941—3
	1942—1

16 draw-bands

The "6" sleeve was installed to close leak in a coupling on March 7, 1939.

As shown on page 8531 of the transcript, you requested that I ascertain how much pipe was replaced when the Ohio Fuel Gas Company rehabilitated the lateral pipe line extending to Richmond, Indiana. A map furnished by the Ohio Fuel Gas Company shows that a total of 3.50 miles of the 10" lateral pipe line which was owned by Ohio Fuel Gas Company was replaced with 8" pipe during the work of rehabilitation. The length of the Richmond lateral between the 16" Line "D" and the Richmond measuring station is 12.44 miles.

As shown on pages 8532 and 8533 of the transcript, you requested that I furnish station numbers for the leaks recently found on the 20" Line "A". We are unable to establish the exact station numbers, but these leaks were located approximately at Stations 1440.90 and 2200.93. (Station 0.00 is just east of Dana Measuring Station.)

We accept this as the testimony of Mr. Young, who is now absent from the city.

[fol. 8706] Have I correctly read into the record, Mr. Baldridge, the information which was furnished to me by Mr. Young in writing?

Mr. Baldridge: Mr. Littman, I have assumed that you have. I have not even tried to check it.

Mr. Littman: And, of course, it is understood that this will constitute Mr. Young's testimony in so far as this record is concerned on the subject which I have covered?

Mr. Baldridge: Yes, of course.

Whereupon ROBERT S. DREW a witness, having been previously duly sworn, resumed the stand and testified further as follows:

Cross-Examination (Continued)

By Mr. Littman:

Q. Mr. Drew, when you were last on the witness stand, I asked you to check certain figures which we asked you to assume were mathematically correct during the course of cross-examination. Have you checked our figures?

A. You refer to this working sheet on the Dow-Jones 30 industrial stocks?

Q. There were some figures in that connection, yes.

A. The addition of the column showing the annual interest and preferred dividends resulted in a figure somewhat different from yours but not substantially so.

[fol. 8707] Q. Will you please read our figure and yours?

A. The figure which you gave me last Friday was \$122,667,567. To that, because of the change relating to the error in the figure on American Smelting, I added \$3,465,900 which makes a total of \$126,132,567.

Our addition resulted in a figure of \$126,110,007 so that there is a differential there of about \$22,000 which is extremely minor in relation to the total figure.

Q. It would not affect the figures that we derived and used in connection with the cross-examination, would it?

A. No, sir, it would not.

Q. In other words, if I correctly understand you, your check of the figures which we asked you to assume when you were last on the witness stand would in no manner change your testimony in connection with those figures?

A. That is correct, yes, sir.

Q. I also requested you, when you were on the stand last, to supply a list of bonds yielding $3\frac{1}{2}$ percent or more whose fixed charges are earned at least 5 times. You recall that this was the assumption you used for Michigan Gas in your rate of return study for that company?

A. Yes, sir.

Q. Have you prepared a list of such bonds which you deem comparable to the bonds proposed for Michigan Gas in your study?

[fol. 8708] A. Yes, sir.

Q. Do you have the list with you? A. I have.

Q. How many bonds do you have on your list?

A. There are fifty bonds on the list.

Q. Do you consider these bonds comparable to those which you propose in your setup for Michigan Gas?

A. I regard these bonds as comparable to the bonds I set up in my hypothetical capitalization in the sense that any public offering of such a hypothetical bond would be in competition for the investor's dollar with such bonds as these, as well as others.

Q. It is in that sense that you consider them comparable? A. Yes, sir.

Q. You do not consider them comparable in any strict sense as being the type of bonds which you would suggest Michigan Gas Transmission Corporation should have?

A. I made no study of these fifty bonds to determine their characteristics other than the figures taken from this printed volume.

Q. Without such a study, you could not determine whether they would be desirable for Michigan Gas, could you?

A. I think such a study would have to be very exhaustive in the case of each one of these bonds to establish comparability with the hypothetical setup for Michigan Gas.

Q. I would like to have this clear on the record. When you made your study for purposes of this proceeding, you did not prepare any list of bonds such as those which you

assumed for Michigan Gas for purposes of your study, did you?

A. I did not prepare such a list as this but, in my regular work, I have considerable contact and am, therefore, familiar with bonds of this character.

Q. But even as late as this date you were not at all certain that any of the bonds on your present list, which has been furnished at our request, have the characteristics of the bonds which you propose for Michigan Gas under your hypothetical rate of return setup?

A. I am certain that many investors, if they were considering the purchase of the hypothetical Michigan Gas bonds, would compare those bonds with such bonds as these as well as others before making the purchase of Michigan Gas bonds.

Q. Mr. Drew, I wish you would listen carefully to my question and endeavor to answer my specific question, please.

Mr. Littman: Will you read the question back, please?

(Whereupon, the question commencing at Line 9 of this page was read by the reporter.)

The Witness: The bonds on this list have two characteristics that are the same as the hypothetical bonds of Michigan Gas; namely, the coverage of fixed charges and the [fol. 8710] rate of the yield on those bonds.

By Mr. Littman:

Q. Now, what other characteristics do they have in common?

A. I cannot say because I have not examined each instance exhaustively in order to compare it with Michigan Gas bonds.

Q. Well, let's examine your list of bonds.

Does your Honor have a copy?

Trial Examiner: Yes.

Mr. Culton: Will you present copies of that list?

Mr. Littman: I do not know whether we shall or not.

Mr. Culton: The rest of us are in the dark.

Mr. Littman: I do not at this stage propose to offer this as an exhibit.

Trial Examiner: I do not think I have a copy of that.

Mr. Littman: I thought you said you had it.

Trial Examiner: No, I misunderstood you.

By Mr. Littman:

Q. You have a list here of 50 bonds. How many of them are public utility bonds, other than railroads?

A. Five.

Q. You have been unable to find any other public utility bonds than the five which you show in your list that have characteristics of 3 1/2 percent yield and fixed charges that [fol. 8711] are earned at least five times. Is that right?

A. That is correct, yes, sir.

Q. All right. Let's examine the first one, which is "Providence Gas, First Mortgage 4 Percent, 1963 Bonds". Now, you show that the yield on these bonds is 3.59 percent and times charges earned is 6.4. Is that right?

A. Yes, sir.

Q. What is the capitalization of Providence Gas?

A. I do not have a record of that here.

Q. I hand you Moody's Public Utilities, 1941, and refer you to Page 67, which shows that information. Before you examine Moody's will you please state whether you consider this Manual of investments a reliable source of information? A. Yes, I do.

Q. What is the amount of common stock outstanding?

A. On December 31, 1940, Moody's Manual indicates that the company had 1,074,028 no-par shares outstanding.

Q. What is the dollar amount of the common stock of Providence Gas outstanding?

A. The book value of the capital stock is shown as \$11,507,445.

Q. What is the surplus as of that date?

A. \$1,452,540.

Q. What was the amount of bonds outstanding at that time? A. \$3,250,000.

[fol. 8712] Q. Now, the total capitalization was \$16,209,985. Is that correct?

A. Well, I did not add it, Mr. Littman. Shall I? \$16,209,985 book value.

Q. So that the bonds represent less than 25 percent of the capital? A. Yes, sir.

Q. Now, you assumed a capitalization for Michigan Gas Transmission Corporation of 50 percent bonds?

A. Yes, sir.

Q. Now, for Providence Gas, which is the first public utility appearing on your list, you have a capitalization of 25 percent of bonds having a yield of 3.59 percent. Isn't that right? A. I beg your pardon, sir?

Mr. Littman: Will you read the question?

(Whereupon, the pending question was read by the reporter.).

The Witness: Yes, sir.

By Mr. Littman:

Q. Now, let's see what rate of return is indicated for this company based upon the coverage of 6.4 times and the yield. Will you calculate that for us?

Mr. Baldridge: This is a manufactured-gas company, is it not?

Mr. Littman: Do you mean to indicate by your question, [Vol. 8713] Mr. Baldridge, that this bond is not comparable to the one, to the type and character of the one assumed by Mr. Drew, for the purposes of his study in this proceeding?

Mr. Baldridge: I do not mean to indicate that in the least but I mean the question of rate of return of a manufactured-gas company in a city like Providence is entirely different from the rate of return of a pipe line company such as Michigan Gas Transmission Corporation. The risks as to the one particular type of securities may or may not be comparable but the over-all return on the two companies certainly is not at all comparable.

By Mr. Littman:

Q. Perhaps we can get at it this way in order to save time. Now, with respect to Providence Gas we have a capitalization of \$25 of bonds and \$75 of capital stock for every \$100 of capital, do we not?

A. Book value, yes, sir.

Q. Now, for each \$25 of bonds, the interest requirement is 90 cents, is it not, per year? The calculation is 3.59 times 25.

A.: Approximately 90 cents, yes, sir.

Q.: Now, that is covered according to your list 6.4 times, is it not? A.: Yes, sir.

Q.: Now, let's multiply the 6.4 times the 90 cents. That [fol. 8714] gives us \$5.76 for each \$100 of capitalization. Is that correct? A.: Yes, sir.

Q.: Now, that indicates that Providence Gas is earning an over-all rate of return of 5.76 percent, does it not?

Mr. Baldrige: On what?

Mr. Litman: On its capitalization.

The Witness: On its book value of capitalization.

By Mr. Litman:

Q.: Yes. And that 5.76 for Michigan Gas Transmission Corporation is comparable to your 8.5 percent, is it not?

A.: I would say that, according to our calculation here, it is the return being earned on the book value of the capitalization of a company whose bonds sell in the same market as would those of Michigan Gas Transmission Corporation if they were to be offered to the public.

Q.: Now, the calculation that you have just made is the same character of calculation which you made for Michigan Gas Transmission Corporation in testing your 8.5 percent return, is it not? A.: No, sir.

Q.: Didn't you testify on direct examination that you were assuming—

A.: (Interposing) I used market value in place of book value.

Q.: But you used this calculation to check the validity [fol. 8715] and reasonableness of your estimate rate of return, did you not?

A.: Not this calculation, no, sir.

Q.: Well, if market value exceeds book value, the rate of the indicated rate of return would be even lower than the 5.76, would it not? A.: That is right.

Q.: And only if the market value is less, in fact very substantially less than book cost could you get a rate of return for this company up as high as 8½ percent. Is not that right?

A.: I think that is right, yes, sir. I might add that at the end of January, Providence Gas Company's common

stock was quoted at about 7 1/4 per share whereas the book value including surplus was about \$13 a share.

Mr. Culton: For my information, I wonder if the reference book you have there shows when the Providence Gas Company commenced business.

The Witness: The statement here is that the company was incorporated under the laws of Rhode Island in 1847.

Mr. Baldrige: And it is a manufactured gas company, of course?

The Witness: Yes, sir.

By Mr. Littman:

Q. Well, is this bond or is this bond not comparable to Michigan Gas Transmission Corporation? Now, you understand I only asked for comparable bonds and I do not want to take up a lot of time on this record talking about bonds that are not comparable. Now, is it or isn't it comparable?

Mr. Culton: I think if you will go back, Mr. Littman, you will find that your question related to comparable coverage and comparable rates of return.

Mr. Littman: It related to that plus bonds which he thought were comparable. I will get the transcript and show you.

Mr. Culton: My recollection is that you used comparable in coverage and comparable in rates of return.

Mr. Littman: Well, your recollection is wholly faulty in that regard, I am sorry to say, Mr. Culton.

By Mr. Littman:

Q. Well, suppose you tell us whether you consider these bonds that you have submitted in this list comparable to those which you propose for Michigan Gas?

Mr. Baldrige: I think he has already answered that, Mr. Littman, earlier this morning.

Mr. Littman: I submit he has not.

The Witness: It seems to me the answer to that question depends almost wholly on the definition of the word "comparable". This is a company located in a different

part of the country. It is a manufactured-gas company, it is a very much older company, it has a bond issue that is a much smaller proportion of the total capitalization [fol. 8717] than the one I suggested for Michigan Gas. There are many phases and factors that are different from those of Michigan Gas Corporation and yet I regard the bonds as comparable in the sense that they are sold and traded in the same general market for securities as would the bonds of Michigan Gas Transmission Corporation have to be sold if offered to the public.

By Mr. Littman:

Q. Shall we then assume for purposes of your study that we are going to have 25 percent of bonds for Michigan Gas and 75 percent of capital stock? Do you want to assume that and agree with us on that?

A. It seems to me that that would be a rather expensive way for Michigan Gas Transmission Corporation to finance itself.

Q. Not if it gets down to something like 5.76 percent against your 8.5.

A. May I give you result of my calculation on Providence Gas on the same basis that I used for the other companies?

Q. Yes.

A. I come out with a figure of almost exactly 8 percent in 1940 on the market value of the securities of Providence Gas.

Q. Now, Mr. Drew, are you willing to agree that for purposes of this study we should have a bond comparable to that of Providence Gas in so far as the proportion of bonds to total capitalization is concerned?

[fol. 8718] A. Not so far as the most economical method of financing the company is concerned, no, sir.

Q. Well, let's see where we come out if we use this ratio. Now, your bonds have a yield of $3\frac{1}{2}$ percent, for Michigan Gas, do they not?

A. Yes, sir.

Q. Assuming that we are going to have, as does Providence Gas, 25 per cent of bonds yielding $3\frac{1}{2}$ percent, the interest requirement is $87\frac{1}{2}$ cents per year for each \$25 of capital raised through bonds?

A. That is correct, sir.

Q. Now, you have suggested a coverage of five times for Michigan Gas. Suppose you multiply that by five to get the over-all rate of return and tell us what the answer is.

A. \$4.375.

Q. For each \$100 of capital?

A. Yes, sir.

Q. In other words, if we had a bond like this for Michigan Gas which represented 25 percent of the total capital and we used your formula, we would have an indicated return of 4.37 percent, would we not?

A. On the basis of your assumption, yes sir.

Q. Well, the assumption that I have made is precisely the situation which exists with respect to Providence Gas, isn't that right?

A. Not quite. Providence Gas coupon is 4 percent.

Q. Well, its yield is 3.59, isn't it?

[fol. 8719] A. Yes, sir.

Q. Which is very close to 3½ which you have assumed for Michigan Gas.

A. That is right.

Q. And Providence has 25 percent of its capital represented by bonds. Is not that right?

A. Yes, sir.

Q. And that is the assumption that we have used in this last calculation. Is not that right?

A. I think that is right, but you are getting the two mixed up pretty well here.

Q. Well, just a minute, Mr. Drew.

Mr. Baldrige: Let him finish his answer.

Mr. Littman: I will give you an opportunity to explain, but I want you to tell me what is wrong with our calculation thus far. Thus far we are comparable, are we not?

The Witness: Not entirely.

By Mr. Littman:

Q. Why not entirely?

A. Well, because you are mixing up the two companies and the two bonds. The Providence Gas bond is a 4 percent coupon. My hypothetical bond for Michigan was 3½. Providence's bonds are 25 percent of capitalization. In my case they were 50 percent. Providence Gas bonds

[fol. 8720] earned their charges over six times and I estimate five times as necessary for the Michigan Gas bonds.

Now, what you are doing here is combining a $3\frac{1}{2}$ percent coupon and a 25 percent ratio of bonds to capitalization and a five-times coverage of interest charges.

Q. Do the Providence Gas bonds have any serial maturities?

A. The bonds are all one maturity. I will have to check and see if there are any sinking fund provisions.

So far as I can see, there are no sinking fund provisions of the Providence Gas bonds.

Q. And you have assumed a sinking fund provision with serial maturities for Michigan Gas bonds in your hypothetical setup in your study for this proceeding, have you not?

A. Yes, sir.

Q. Are the bonds of Providence Gas callable?

A. They are.

Q. At what price?

A. 105.

Q. They are selling on the market for more than that, are they not?

A. I am sorry, that is 103. I looked at the wrong figure.

Q. 103 is the call price?

[fol. 8721] A. Yes, sir. May I correct that.

Q. And they are selling for about 106, aren't they?

A. Yes, about 106.

Q. What is the yield to the first call date?

A. I have no way of calculating that.

Q. Is it something less than zero?

A. I cannot answer that question.

Q. It is much less than 3.59 percent, isn't it?

A. Well, the bonds are callable on 30 days' notice as a whole at any time or, in part, on any interest date to each February 1.

Q. And that is keeping the price of these bonds down, isn't it?

A. I think it is, yes, sir.

Q. Now, let's examine this bond for a moment. Here is a bond that is callable at 103 and has a market price.

of 106. If I bought this bond today at 106 I would do so well knowing that within 30 days that bond might be called at 103 and might lose the \$3 that I invested, might I not?

Mr. Baldridge: I do not think that is what Mr. Drew is saying, Mr. Littman. What I understood him to say was to each February 1.

Mr. Littman: Is that what you said?

Mr. Baldridge: I think it is ambiguous, at least to me.

Q. The Witness: I read the provisions from Moody's.

[fol. 8722] Mr. Littman: Mr. Baldridge is incorrect, is he not?

The Witness: I will read the provisions again.

Mr. Baldridge: Read the commas too, the punctuation.

The Witness: "On 30 days notice as a whole at any time or in part"—and with no comma—"on any interest date to each February 1 inclusive as follows" and then there is a list of the call prices.

By Mr. Littman:

Q. Let me pose my question again.

If I went into the market and bought this bond at \$106 I would do so well knowing that within a very short time, the bond may be called at \$103. Isn't that right?

A. That is correct but you would have the knowledge, if you looked into it, that the bond has been outstanding quite a while and has not been called and, in the meantime, has been sold up as high as 108 and a fraction.

Q. Would you, as manager of your Trust Department, advise a prospective investor that this bond would not be called?

A. I would have no way of giving him that assurance, of course.

Q. Now, if I bought this bond at \$106 today at the present market price and if this bond were called within six months, I would lose \$3, wouldn't I?

A. So far as principal is concerned, you would, yes, sir.
[fol. 8723] Q. How much interest would I have received?

A. You would have received \$2 a hundred in the meantime.

Q. So I would have, under that assumption, a negative rate of return of \$1, wouldn't I?

A. That is right.

Q. You did not suggest any such thing for Michigan Gas Transmission Corporation, did you?

A. No, sir.

Q. Now, the next public utility bond on your list is St. Louis County Gas, first mortgage, 5 percent, 1951, having a yield of 4.20 percent, which is earning 6.6 times the interest charges. Is my statement correct?

A. Yes, sir.

Q. Mr. Coffman eliminated this company from his list in his rate of return, Exhibits Nos. 63 and 64, did he not?

A. As I recall it, it was excluded from his study because its common stock was owned by a holding company. I believe that is what he stated.

Mr. Culton: Mr. Littman, would you object to my reading a question which you asked the other day in order to clear my own skirts in this matter? On page 8451, your inquiry addressed to the witness was as follows:

"Suppose you just name one or two bonds that you can find in your list that you have anywhere in the Financial World, pipe line companies or otherwise, that have an in-[fol. 8724] terest coverage of five times and in interest rate of 3½ percent on its bonds?"

That was the statement.

Mr. Littman: That was a follow-up question on the original question.

Mr. Culton: Your original question used the word "comparable" but you finally got down to "any bond". I just wanted to clear my own statement that I made a while ago in the record which you challenged.

Mr. Littman: I can understand why you came to the conclusion that you did, Mr. Culton, but that question must be read in connection with the full context of the transcript and the other questions that preceded it which used the term "comparable".

Mr. Culton: I thought you were wrong in your inquiry in that question there.

By Mr. Littman:

Q. Mr. Drew, you understood my inquiry to relate to comparable bonds, didn't you?

A. I remember your saying "Comparable bonds" and again I say that it depends upon your interpretation or definition of the word "comparable".

To me, the investor, in considering a bond for his own purchase, is very likely to compare that bond with many other types of bonds which are available in the market and not only that, but investment counsel and investment [fol. 8725] bankers are continually digging up bonds of various characteristics for the consideration of their clients.

Q. Did you undertake here in this list to supply a list of bonds which you considered comparable?

A. From the standpoint of my definition of the word "comparable", yes, sir.

Q. So you did not misunderstand my question, did you?

A. I put my own interpretation on the word "comparable" because my viewpoint is the investor's viewpoint which may be different from yours and because time did not permit; in any event, the exhaustive study which would have been required to establish the comparability of these or any other bonds with those of Michigan Gas Transmission Corporation.

Q. Is it your testimony that an investor would prefer to invest his money in these Providence Gas first mortgage bonds in preference to the bonds which you suggest for Michigan Gas?

The Witness: Will you read that, please?

(Whereupon, the pending question was read by the reporter.)

The Witness: That is by no means my testimony.

By Mr. Littman:

Q. In fact, the contrary would most decidedly be your testimony?

A. I believe it would on the basis of this price relative [fol. 8726] to call price, yes, but I would say this, that if these bonds dropped one point in price or one point and a half, it is quite possible that you would find buyers for those bonds and I am speaking of the Providence Gas 4's.

Q. However, so long as any of the bonds which you have shown on your list are selling above the call price, you would say, would you not, that no investor would prefer such bonds on your list as against the bonds which you proposed in your hypothetical setup to issue for Michigan Gas?

A. No, sir, I could not make that statement.

Q. Let's look at St. Louis County Gas Company, first mortgage, 5 percent, 1951 bonds, having a yield of 4.20 percent and earning 6.6 times its interest. That is a rather high coupon rate, isn't it, Mr. Drew?

A. In present-day financing, it certainly is.

Q. Now, these bonds could be refinanced at a lower coupon rate, could they not?

Mr. Baldrige: May I have that last question read?

(Whereupon the pending question was read by the reporter.)

The Witness: Without having made an exhaustive study of the bonds themselves or of the company, my opinion is, from the figures readily available here, that those bonds could have been refunded anytime in the last two or three years. It is interesting to note that they have not been.

[fol. 8727] By Mr. Littman:

Q. What is the current market price of those bonds?

A. 106.

Q. That is above call price, isn't it?

A. One point, yes, sir.

Q. Now, what is the capitalization of St. Louis County Gas Company? You will find that on page 1323 of Moody's Public Utilities-1941.

A. Moody's Manual shows, for December 31, 1940, book value, first mortgage bonds, \$1,500,000.

Q. What is the capital stock and surplus?

A. The capital stock is shown at \$4,100,000 and the surplus as \$2,288,948.

Q. So that these bonds represent less than 20 percent of the capitalization of the company, do they not?

A. On book value, yes, sir.

Q. What is the amount of interest required on \$20 of these bonds per year in terms of yield?

A. Five percent.

Q. Isn't it 4.20 that the investor is getting?

A. The company has to pay 5 percent on a million and a half of bonds.

Q. All right. Let's take the 5 percent.

A. Five percent on \$20, did you say?

Q. On \$20 of bonds.

[fol. 8728] A. \$1 for interest.

Q. Now, the coverage is 6.6 times, isn't it?

A. Yes, sir.

Q. Indicating a 6.6 rate of return for that company?

A. Based on its book value, yes, sir.

Mr. Baldridge: Mr. Drew, that is a mixed gas distributing company, is it not?

The Witness: Yes, sir.

By 3 Littman:

Q. Well, have you been able to find any natural gas pipeline companies that have any securities, such as those which you suggest for Michigan Gas Transmission Corporation? I am speaking of bonds.

A. There are none in this list, no, sir.

Q. In other words, you have not been able to find any so far? A. That is correct.

Mr. Baldridge: You mean that have the characteristics you mentioned of times charges and yields?

Mr. Littman: Yes.

Have you been able to find any natural gas companies that have the bond characteristics of those which you suggest in your hypothetical setup for Michigan Gas?

Mr. Baldridge: You mean that are openly sold on the market? You must make that qualification.

[fol. 8729] Mr. Littman: I am not making any such qualification.

By Mr. Littman:

Q. You do not have any such bond on your list, do you?

A. Just a second—the sixth bond on the list, New Mexico Gas bonds, appear to be from the Manual here, although I have not had a chance to study the bond or the company, appears to be a natural gas distributing and transmission company.

Mr. Littman: Will you please read that last answer?

(Whereupon, the last answer was read by the reporter.)

By Mr. Littman:

Q. I hand you Standard & Poor's "Bond Investments", issue of September 6, 1941, and ask you whether the advice of Standard & Poor's with respect to Providence Gas 4's is to "switch"?

A. Yes, sir, it is.

Q. What does the word "switch" mean as it is used there?

A. It means to sell the bond to somebody else who is willing to buy it and then reinvest the proceeds of your sale in some other bond.

Q. In other words, in the words of a layman, to "get rid of it quick", isn't that right?

A. No, I do not interpret it that way.

Q. Would you say plain "get rid of it"?

A. No, sir.

[fol. 8730] Q. Get rid of it and invest your money in something else?

A. Well, I do not like the words "get rid of it", because I do not interpret Standard's "switch" recommendation to mean that. It means, as I said, to sell the bond to somebody else who is willing to buy it at a price that is mutually agreeable and reinvest the proceeds of your sale in some other security.

Mr. Littman: Mr. Examiner, I see the recess hour has come and gone. I hope we are not foreclosed from our usual brief recess.

Trial Examiner: We will take a five-minute recess.

The Witness: I should like to add one comment on Providence Gas, if I may, before we finish.

In Fitch Bond Record of February 24, 1942, Providence Gas Company bonds are quoted at 106½ bid, not asked but bid, and that means that somebody is willing to pay 106½ for those bonds.

By Mr. Littman:

Q. And if that "somebody" paid \$106.50, his yield would be even lower than we have already indicated, would it not?

A. Very slightly.

FRED A. SPITZNAGLE, a witness, having been previously duly sworn, resumed the stand and testified further as follows:

[fol. 8732] Trial Examiner: Mr. Chamberlain has now handed to the Trial Examiner revised Exhibit No. 166 in accordance with our understanding. While the original was received, it was received last Saturday, the new exhibit may be marked 166 and substituted in the file for the original.

(The Document Referred To Was Marked No. 166 and Received In Substitution For The Original Exhibit No. 166.)

Q. Mr. Spitznagle, have you examined Exhibit 166 which is now handed you?

A. Yes, sir, I have.

Q. And have you checked the figures that appear on that exhibit?

A. Yes, sir, I have checked the figures both with the original exhibit, in so far as the original exhibit contains the same figures, and I have also checked the record which begins at Page 8486.

Exhibit 166, which you are now handing to me, has an error in the figure in the 1932 column under the caption "Amount". The last item should be \$1,097.92 instead of 72 cents.

Q. And that has been corrected on all of the copies that have been presented?

A. Yes, sir, I gave it to you and I think it has been corrected.

Q. Now, this data relates to the sales of natural gas and [fol. 8733] purchases by the companies that are identified in the left-hand column.

A. That is correct; yes, sir.

Q. And those you find to be correct both as to quantity and the amount of the purchase price?

A. Yes, that is correct.

Q. Now, have you obtained the gas revenues of Indiana Gas Transmission Corporation for the years 1931 to 1935, inclusive?

A. Yes, sir, and I will be glad to read them off to you.

Q. If you please.

A. For the year 1931, \$79,063.62.

The Witness: There are only five figures involved.

For the year 1932 such revenues were \$596,898.57.

For the year 1933 they were \$547,315.45.

For the year 1934 they were \$604,434.81.

For the year 1935 they were \$784,555.31.

[fol. 8734] By Mr. Chamberlain:

Q. I will ask you again: the revenues for 1932.

A. \$596,898.57.

Q. I now hand you the document marked for identification as Exhibit 169 and I wish to ask whether you have checked the figures as well as the percentages given in this document.

A. Yes, sir, I have, but I would like to have you refer to the percentages as revenue per M. c. f. They are really not percentages, they are percent amounts.

[fol. 8735] Q. Now, will you state for the purpose of the record what the increase in the sales in M. c. f. for the year 1941 has been as compared with the year 1936? I am referring now to Michigan Gas Transmission Corporation's sales.

A. The percentage that it shows on the Exhibit 169 I believe excludes the non-affiliates, if I am correct.

Q. That is right.

A. Excluding the non-affiliates the percentage increase was 324.03.

[fol. 8736] Q. What was the percentage increase of sales of natural gas by Michigan Gas Transmission Corporation to non-affiliates in the year 1941 as compared with the year 1936?

A. Percentage increase of sales in M. c. f. was, as I stated, 324.03 percent.

Q. And what was the increase in revenue for 1941 over the year 1936?

A. With respect to the same companies the percentage increase in revenue was 268.68 percent.

Q. And with respect to the same companies and period, what was the increase as a percentage in the revenue received per M. c. f.?

A. 13.06 percent.

[fol. 8737] Q. Now, I wish to call your attention to the five customers of Indiana Gas Transmission Corporation as of the first two months of the year 1936 and to the percentage of gain or loss in their sales during the period from 1936 to the end of 1941, inclusive. What was the percentage of increase or decrease in the sales of natural gas by Michigan Gas Transmission Corporation to these five customers who continued to be customers throughout the period and all of which were non-affiliated in the year 1941 as compared with the year 1936?

A. The customers to which you refer are on the second page and the sales of Indiana Gas Transmission Corporation to those customers for the period 1936 to 1940, inclusive, appear on that page. The percentage increase in sales of M. c. f. to those customers in 1941 over the year 1936 is 247.93.

Q. And what was the increase in revenue with respect to the same companies and conditions?

A. The increase in revenue was 191.36 percent.

Q. And what was the percentage decrease in revenue per M.c.f. with the same companies and under the same conditions?

[Vol. 87381] A. The decrease in revenue per M.c.f. was 16.26 percent.

Q. Now, what was the percentage decrease in revenue per M.c.f. derived by Michigan Gas Transmission Corporation from sales of natural gas to non-affiliated customers in 1941 under the revenue per M.c.f. to Indiana Gas obtained from Michigan Gas Transmission Corporation as compared to the same non-affiliated customers in 1936?

A. Such percent was 19.25 percent.

Mr. Chamberlain: The Intervenor now offers in evidence, as a part of the cross-examination of Mr. Spitznagle, Exhibit No. 169.

Trial Examiner: Any objection? (No response.)

The statistical table, consisting of two sheets, concerning which questions have just been asked, will be marked for identification as Exhibit 169 and will now be received in evidence as Exhibit No. 169, without objection.

(Exhibit No. 169 was marked and received in evidence.)

[Vol. 8741] ROBERT S. DREW, a witness, having been previously duly sworn, resumed the stand and testified further as follows:

Cross Examination (Continued)

[Vol. 8742] By Mr. Littman:

Q. Mr. Drew, you show on your list New Mexico Gas, first convertible 5 1/2 percent, 1951, bonds. What is the capitalization of that company as shown by Moody's 1941 Public Utilities?

A. As I stated, I have not examined into the detailed characteristics of any of these bonds, Mr. Littman.

Q. It is important to do that, isn't it, to determine whether or not these bonds are reasonably comparable to those which you propose in your structure for Michigan Gas?

A. It would be, yes, sir, but I have made no attempt to do that.

Q. Is there any bond on your list which you consider as good an investment as the 3½ percent bonds which you have proposed for Michigan Gas Transmission Corporation?

A. Since I have not made a detailed study of these bonds, I think the best way for me to answer your question is to say that I would regard those hypothetical 3½ percent Michigan Gas Transmission Corporation bonds as entitled to a rating of BBB and on the list of 50 bonds which you have before you, the entire list down to and including Crucible Steel, 3¼, are rated BBB or better in the Bond Tabulator.

Mr. Baldridge: That constitutes about 25 different issues of bonds, does it not, Mr. Drew?

The Witness: Exactly 25, yes, sir.

[fol. 8743] By Mr. Littman:

Q. How would you rate Panhandle Eastern's recent issue of 3 percent bonds?

A. I think they are worth a AA rating, between A and AA, in my opinion.

Q. How would you rate Panhandle Eastern Pipe Line Company's 3 percent bonds of 1960?

A. I think I would rate them about the same, AA.

Q. The rating on those bonds, as shown in the September 6, 1941, issue of Standard & Poor's "Bond Investment" was A1. Isn't that correct?

A. That is AA. That is the same as AA or double A. Triple A is the same as A1 plus. Different Services use different codes.

Now, I have before me again this Fitch Bond Record and Fitch rates the new 3 percent bonds as A and rates the 3's of 1960 the same.

Q. How did you rate the Michigan Gas Transmission bonds which you have proposed for purposes of your study?

A. I think about BBB.

Q. Why is the Panhandle Eastern Pipe Line Company bond due 1960 a better one than the one you proposed to issue for Michigan Gas Transmission Corporation?

A. In my opinion, there are several factors that probably lead the Service organizations to rate Panhandle [fol. 8744] Eastern bonds either A or AA as compared to my opinion as to the ratings of these hypothetical Michigan Gas Transmission 3½'s.

Q. What are those factors that cause Panhandle Eastern's bonds to be rated better than your hypothetical bonds for Michigan Gas?

A. I think the fact that Panhandle Eastern owns certain gas reserves, is a company having been established longer than Michigan Gas Transmission, serving a wider territory and having, I think, more possibilities of branching off to reach other territories.

Q. Don't you know that all of the outstanding securities of Michigan Gas are now owned by Panhandle Eastern Pipe Line Company?

A. I understand that they are but you are asking me about the relationship between two pieces of property upon which are two separate bond issues, respectively.

Q. Isn't the natural gas supply of Panhandle Eastern Pipe Line Company available to Michigan Gas Transmission Corporation?

A. I would expect so, but I would say it was not necessarily so at the time that I set up this hypothetical bond issue.

Q. Would you change the rating on your hypothetical bonds today in view of the events that have transpired since you made your study originally?

A. No, sir. As compared to Panhandle Eastern, Mich [fol. 8745] igan Gas Transmission Corporation, as I understand it, takes the gas at a certain point, transmits it up to another point, and has a contract for the delivery of the gas to one large customer and perhaps other smaller customers.

Q. You understand that these two companies are proposed to be operated more or less as a single unit, don't you?

A. I presume they will be.

Q. What exists today in respect of this situation that would cause you to rate Michigan Gas Transmission bonds below those of Panhandle Eastern?

A. Because the bonds, I assume, would be a lien on two separate parts of the property. Otherwise, we would

be talking about another issue of Panhandle Eastern bonds.

[fol. 8747] (Exhibit No. 167 was received in evidence.)

Q. Mr. Drew, you show on your list New Mexico Gas first convertible 5 percent 1951 bonds having a yield of 4.48 percent and earning 7.4 times interest earned.

A. Yes, sir.

Q. Now, I hand you Standard & Poor's "Bond Investment", dated December 6, 1941, and refer you to page [fol. 8748] No. 612. Will you please state what is shown thereon with respect to the interest coverage on those New Mexico bonds?

A. Standard & Poor's publication, which you have just described, shows a coverage of 3.45 times.

Q. Whereas your list shows 7.4 times, does it not?

A. That is correct, yes, sir.

Q. Can you explain the difference between the figure shown in your list and the figure shown in Standard & Poor's?

A. No, I cannot explain the difference. I verified, however, that the Bond Tabulator shows the coverage of 7.4 times.

Q. Well, they cannot both be right, can they?

A. Not if that coverage is for the same period, that is correct.

Q. It is for the same period, is it not?

A. The Bond Tabulator does not give the period covered while Standard & Poor's figure is for the year 1940.

Q. Well, if Standard & Poor's is correct, then clearly this New Mexico Gas bond would not be comparable and should not be shown on this list?

A. That is correct.

Q. Now, the only remaining public utilities which you have on this list, other than those which we have heretofore discussed, are two street-railway companies. Is that right?

A. You refer to the Cleveland Railway sinking fund [fol. 8749] 5's and the New York Railway 6's or 58?

Q. Yes. Are there any other public utilities shown?

A. I think those are the only ones remaining.

Q. Now, we have heretofore discussed three public utilities, to wit, Providence Gas, St. Louis County Gas and New Mexico Gas, have we not?

A. Yes, sir.

Q. The other two public utilities, as you have just stated, are street-railway companies, making five public utilities in all on your list of 50 companies?

A. Well, I think they are both street-railway companies. You made the statement, I described the bonds. I think, however, they are both street railways. It may be, however, that the New York Railway bonds may have some power business. I do not know. The Manual will show.

Q. Well, it is clear at any rate that the remaining 45 bonds shown on your list are not public utility bonds?

A. I think that is correct.

Q. The New York Railway bonds are selling above call price, are they not?

A. The bid price in the Bond Tabulator is shown as 105 which is also the call price.

Q. Now, with respect to the Cleveland Railway sinking fund first mortgage 5 percent bonds due 1945, that company has an issue of cumulative common stock, does it not? [fol. 8750].

A. I do not know, sir. I have not the details of the capitalization before me.

Q. I hand you Moody's Public Utilities for the year 1941 and ask you to verify my understanding.

A. That is correct.

Mr. Baldridge: Mr. Littman, did you say "cumulative common stock"?

Mr. Littman: Yes. A rather startling and unusual thing. Have you ever heard of any such stock, Mr. Baldridge?

Mr. Baldridge: Am I off the record?

Mr. Littman: No, you are on the record.

Mr. Culton: I thought all common stock was cumulative.

Mr. Baldridge: I really don't know whether I have or not, but it certainly is not the kind I am accustomed to hearing about.

Mr. Littman: If the inflection of your voice could be put on the record, I do not think there would be any doubt that you were surprised.

Mr. Baldridge: I thought you were going to say "cumulative preferred stock". "Preferred" is the word I expected to hear after "cumulative" and I thought you had just misspoken yourself.

By Mr. Littman:

Q. And that is a very unusual character of security, is it not?

[fol. 8751] A. It is to me, sir.

Mr. Culton: I wonder, just to satisfy our curiosity, if it is described any further there. Does it mean that there is a recapture clause of some kind? In what way is it cumulative?

By Mr. Littman:

Q. Are you ready to answer the question?

The Witness: Will you read the last question?

(Whereupon, the question commencing at line 2 of this page was read by the reporter.)

The Witness: I do not find in Moody's Manual any description of the cumulative provision of the common stock of Cleveland Railway Company.

By Mr. Littman:

Q. That cumulative characteristic of the common stock might have something to do with the investor's appraisal of these bonds, might it not?

A. I should not think so.

Q. You do not think that would affect the situation any?

A. No, sir.

Q. I note on page 60 of Moody's 1941 Manual of Investments for Public Utilities, that there was a deficit in the interest fund of Cleveland Railways of \$5,358,101, that amount appearing on the liability side of the balance sheet as of December 31, 1940. I also see a notation with respect to the same item for 1939 reading as follows:

"After provision for unpaid dividends of \$4,552,188, the Interest Fund is described as follows:

"Interest Fund, year ended December 31, 1940: Deficit at January 30, 1940 (after provision for accumulated unpaid dividends) \$4,806,915. Add: Net loss for the year computed on the basis of franchise allowances (after provision ~~of~~ \$1,883,664 for cumulative dividends on common stock), \$1,016,383; total, deficit \$5,823,279. Deduct: Balance transferred from operating reserve at February 28, 1940, \$465,196; Deficit, December 31, 1940, \$5,358,104."

Would an investor who contemplated investing his money in these Street Railway bonds take into account this very unusual cumulative common stock and the other facts which I have just read into the record?

A. I am quite sure an investor, considering the bond, would take those things into account but I should be very much surprised if the principal and the interest on these first mortgage bonds which are due in 1945, I would be very much surprised if they did not represent a prior lien on both the property and the earnings of the company.

[Vol. 8753] Q. Speaking of liens, do you consider the liens on property important?

A. Yes, sir.

Q. Do you know whether there is any lien on property secured by the next bond shown on your list, to-wit, American I. G. Chemical Convertible debentures 5½ percent due 1949?

A. I would expect that there would be no mortgage lien on any property of the company.

Q. Is there any other kind of lien on the property?

A. Represented, by those bonds?

Q. Is there?

A. I beg pardon?

Q. Is there any other kind of lien on the property that secures those bonds?

A. Without examining the indenture under which the bonds were issued, I would judge, by the description of the bonds, that it ranks as a general obligation of the company.

Q. And has no lien securing the payment thereof?

A. Well, it might have a lien on certain parts of the property.

Q. And it might not?

A. And it might not. I cannot determine because I have not looked at the indenture.

Q. But, offhand, it looks to you like merely a general obligation of the company?

[fol. 8754] A. Yes. It is, in that way, similar to certain other bonds of much higher rating than this one, such as American Telephone & Telegraph debentures which are a general lien but have no direct lien on property. They are general obligations of the company.

Q. What are the American Telephone & Telegraph debentures selling for and what is the yield?

A. Fitch Bond Record of February 24 shows those debentures selling at prices to yield around 246 to 288 percent to maturity.

Q. I note on page 2894 of Moody's Manual of Investments for Public Utilities for 1941, in [referring] to the American I. G. Chemical Corporation convertible debentures, 5½'s due 1949, contains the following statement:

"Security not secured by any lien".

You do not doubt the accuracy of that statement?

A. I think that is correct, no doubt.

Q. Isn't this the Chemical Corporation that is owned by German interests?

A. I believe not.

Q. And is now subject to an inquiry by the Department of Justice?

A. It may be.

Q. You did not [inquiry] into that?

A. No, sir, I did not inquire. I have not examined into [fol. 8755] the circumstances or the terms or the description of any of these bonds.

Q. Mr. Drew, can we agree that in order for these bonds which you show in your list to be reasonably comparable with the bonds which you have proposed for Michigan Gas Transmission Corporation for purposes of your study, such bonds should constitute at least 50 percent of the capital structure of the company?

A. No, sir.

Q. That is the ratio of bonds that you have assumed for Michigan Gas Transmission Corporation, is it not?

A. That is correct.

Q. And yet you say that that same feature is not required to render these other bonds comparable to that which you have assumed for Michigan Gas Transmission Corporation?

A. In answering your question, I would like to say this, that my viewpoint represents the investor's viewpoint and an investor who has funds with which he wants to purchase bonds does several things.

First, he looks at his portfolio and he determines whether or not he has the kind of diversification among different industries that he should have among his portfolio. He looks at his portfolio from the standpoint of diversification of maturities. A conservative investor would like to have or should have a ladder of maturities in his portfolio. [fol. 8756] He must decide for himself how much risk he is willing to assume from the purchase of a new investment.

He must decide for himself what income from that investment he wishes to obtain.

Having reached conclusions on these and some other points, he is not restricted to any field of investment. He is not restricted to gas pipe line securities nor natural gas securities nor to utility securities. Practically speaking, the entire field of investment is open to that investor and if he has decided that he would like to buy with this money at hand an investment which will pay him $3\frac{1}{2}$ percent or better and if he feels that he would like to have a coverage of his interest charges in the neighborhood of five times or better and if he is willing to buy or, at least, consider some bonds which have a rating of less than BBB, then this entire list of bonds would be available to that investor for consideration for purchase and, as such, he will consider that list of bonds comparable to the hypothetical bond issue of Michigan Gas Transmission Corporation.

Q. Now, you say you have a list here of 50 bonds which might conceivably be comparable?

A. I did not say it that way. I said I thought every bond on this list might well be considered by the investor having reached the conclusions which I just stated.

Q. How many bonds did you examine in arriving at this list of 50?

[fol. 8757] A. At your request last Friday that a list of bonds be submitted which bore a return to present prices of $3\frac{1}{2}$ percent or better on which companies were recovering their fixed charges five times or better, time permitted me only to look through "The Bond Tabulator" and to select bonds which qualified under that suggestion of yours and, as a result, these 50 bonds are submitted.

Q. How many bonds are there listed in that Bond Tabulator?

A. I have no idea, sir.

Q. It would run well into the hundreds, wouldn't it?

A. I am sure it would.

Q. Approximately how many?

A. Well, it would be several hundred.

Q. How many pages of bonds are listed in "The Bond Tabulator"?

A. Fifty-four pages.

Q. How many are there on each page, on the average?

A. About 84.

Q. That would be approximately 4,500 bonds, wouldn't it?

A. I think it would, yes, sir.

Q. Mr. Drew, I consider a bond to be reasonably comparable with those which you propose to issue for Michigan Gas when it has the following features:

[fol. 8758] 1. When the bond constitutes at least 50 percent of the capital structure of the company which is precisely what you assumed for Michigan Gas:

2. Where the bond is selling to yield $3\frac{1}{2}$ percent or more, which is what you assumed, more specifically, you assumed $3\frac{1}{2}$ percent;

3. The bond should be selling at or below its call price;

4. The bond should be earning charges five times and have prospects of such continued earnings. Furthermore, the company which has these bonds outstanding should have reasonable and adequate depreciation reserves on its books.

Now, that is my definition of "reasonably comparable" and I shall ask whether you have found any bonds

among the 4,500 which you examined which have all of those characteristics.

Mr. Baldridge: The witness did not say he examined 4,500, Mr. Littman.

By Mr. Littman:

Q. Didn't you examine 4,500?

A. "Examine" is too strong a word. As I say, I looked through this volume, "The Bond Tabulator" for the purposes I formerly stated.

Q. Did you find any bonds in the list of 4,500, approximately, that met the characteristics which I have described?

A. I made no such search.

[fol. 8759] Q. Do you think there are any in there that have these five characteristics which I have described?

A. I have no way of even guessing at that but I should say that from my own viewpoint, representing the investor's regard for investors, that a strict compliance to any set of specifications like this would be utterly unnecessary to the investor who is studying a number of bonds in order to select one for his own purchase.

Q. But you have imposed precisely every one of these five conditions and characteristics that I have named upon the proposed bonds for Michigan Gas Transmission Corporation. Isn't that right?

A. That is correct.

Q. What is unreasonable about my assumption that these five characteristics should appear in other bonds for those other bonds to be comparable?

A. In setting up that hypothetical capitalization, I was undertaking to do two things: I was undertaking to set up a capitalization which would be pretty close to the most economical method for Michigan Gas Transmission Corporation to use in financing itself entirely and, at the same time, to come out with securities which would be acceptable to the investing public.

Q. You would not have any difficulty finding bonds in this list of 4,500 which met the five characteristics that [fol. 8760] you have used for Michigan Gas which are selling to yield about 2.75 percent including the Telephone Company bonds which you mentioned?

A. Are you asking me a question, sir?

Q. Yes.

A. I think that is correct but I would have to add to that that this set of specifications which you have just described—

Q. (Interposing) They are your set of specifications.

A. All right, my set of specifications are only a part of the number of factors to which an investor would give attention in considering the purchase of securities.

Q. And where you would find those specifications, you will find a yield of 2.75 percent, wouldn't you, or thereabouts?

A. I should say that considering just these specifications, the yield would run anywhere from 2.75 to 6.89, perhaps. I have not studied that.

Q. Suppose you find some of those for us. We are using your own characteristics on these bonds. You cannot point to any now, can you?

A. I cannot, offhand, certainly. I cannot carry those details in my mind.

Q. Now, when you went about the task of fixing what you considered to be a reasonable return to which Michigan Gas Transmission Corporation was entitled, didn't [fol. 8761] you consider it important to first make a study of the situation?

A. No, sir, not beyond my everyday contact with securities.

Q. Well, at any rate, as you have heretofore testified, you have not made an investigation which would enable you to now say that the 50 bonds shown in your list submitted today are reasonably comparable with the bonds which you propose for Michigan Gas Transmission Corporation, considering the features which I [unnumerated] a moment ago?

A. Well, I must make this condition, that I am looking at that question from the standpoint of the investor and from the standpoint of the investor he would have the means and he probably would have the inclination to make a comparison of Michigan Gas Transmission bonds with these very bonds and others and, therefore, for my purposes they are comparable.

Q. Will you please answer my question? You said you were going to qualify your answer, but you have not answered my specific question.

Will you please read it?

(Whereupon, the question commencing at line 5 of this page was read by the reporter.)

The Witness: I have not made such an investigation.

By Mr. Littman:

Q. Mr. Drew, I would like to buy a bond at par that [fol. 8762] would yield me $3\frac{1}{2}$ percent and will have the characteristics which you have prescribed are necessary for the bonds which you propose for Michigan Gas Transmission Corporation.

Can you advise me where I can buy such a bond?

Mr. Baldridge: Mr. Littman, you used the words "prescribed are necessary". That is not my understanding of the witness' testimony.

Mr. Littman: Whether it is your understanding or not, this witness has no difficulty understanding my question. I am satisfied. He thinks he is able to take care of himself.

Mr. Baldridge: It is not a question of taking care of himself, it is a question of confusing the record.

Mr. Littman: I think you have succeeded admirably in confusing this record all week, Mr. Baldridge, by countless, needless interruptions. Are you objecting to this question or not?

Mr. Baldridge: Unless you will rephrase it, I will. I was giving you an opportunity to rephrase it, out of courtesy. If you do not appreciate that, I will object.

Mr. Littman: Mr. Examiner, the objection is, of course, not well taken simply because counsel does not understand the question. The question is objectionable only if the witness does not understand the question and he has not so indicated.

Mr. Baldridge: I think that any question is objectionable when you state that the witness has testified to something that the record does not show he is testifying. If I [fol. 8763] am wrong, I stand to be corrected, but my understanding of the record is that the witness did not prescribe as necessary any conditions as to bonds. He recom-

mended certain kinds of bonds. I think there is a vast difference between those two uses of the words.

Trial Examiner: Read the question.

(Whereupon, the question commencing at line 25, Page 8761 of this transcript was read by the reporter.)

Trial Examiner: I think that question is clear. He may answer. Of course, you may qualify, Mr. Drew, if it is necessary. The testimony, as I recall it, a few moments ago was that the description of a bond, a hypothetical bond which Mr. Littman read by numbered paragraphs expressed the conditions of the bond which you had used in your suggested refinancing plan, that you assented to that fact, to that statement. Am I right?

The Witness: That is correct, Mr. Examiner.

Trial Examiner: You may answer.

The Witness: In my direct testimony the wording of the paragraph preceding that hypothetical setup was this:

"Under present conditions I believe the most economical method of financing publicly a company like Michigan Gas Transmission Corporation, assuming a total capitalization of \$13,000,000, would be to set up a capitalization, one half serial bonds and one half common stock. My [fol. 8764] opinion is that the following setup would be favorably received by the investing public."

By Mr. Littman:

Q. Will you please read on so that we may have these characteristics?

A. "\$6,500,000 3½ percent serial bonds, one to 16-year maturities and \$6,500,000 common stock."

Q. You mentioned something about coverage in there, too, did you not?

A. Shall I read the full paragraph?

Trial Examiner: Since it has been brought into question, Mr. Drew, it would be proper to read it if you wish.

The Witness: "\$6,500,000 3½ percent serial bonds, one to 16-year maturities. Interest the first year would be

\$227,500 which would have to be covered at least five times after taxes. This would require a gross income of \$1,137,500. Interest and serial maturities combined would be covered 1.8 times.

"I believe these bonds could be sold to net the company an average of about par. \$6,500,000 common stock after \$227,500 interest and \$406,250 annual serial maturity total \$633,750. There would remain \$503,750.

"Price-earnings ratio for the first year would be about 13. The rate of earnings on the common stock would be 14 percent before serial maturities and 7.7 percent after [fol. 8765] such maturities. Total, \$13,000,000 total capitalization.

"The \$1,137,500 gross income required for this setup would be about 8 3/4 percent on the \$13,000,000 capital."

B. Mr. Lattman:

Q. Now, will you refer me to a bond such as that which I have described a minute ago?

A. I cannot refer you to such a bond without considerable study and it would be only fortuitous circumstance if I were to find one of that exact specification, but I would say I never heard of an investor who set down such a strict set of specifications when he wanted to make an investment.

Q. Such a strict set of specifications which you, yourself, have prescribed for Michigan Gas?

A. That is correct.

Q. Mr. Drew, does your bank, when acting as Trustee, guarantee any of its beneficiaries against the effects of inflation?

A. No, sir.

Q. Do you know of any Trustee that does?

A. No, sir.

Q. Your bank would soon go broke if it did anything like that, would it not?

A. I cannot say as to that, but I would not want to take the risk.

[fol. 8766] Q. Certainly if it continued to pay current yields it would soon end up on the financial rocks, so to speak, would it not?

A. Your question is not clear to me, sir.

Q. Assuming that your bank guaranteed against inflation and, also, continued to pay the yields which it now pays on its trust funds, it certainly would get into financial difficulties very soon, would it not?

A. Your question still is not clear, but I can answer in the affirmative because I think it would ultimately get into trouble with any kind of a guarantee.

Q. Is any investor that you know of able to hedge his investments against inflation today?

A. So far as I know, there is no perfect hedge against inflation, no, sir.

Q. If the investor in public utility securities were to be given a complete hedge against inflation, he would certainly be the most favored of all investors, would he not?

A. I should say so, yes, sir.

Q. He would probably accept a nominal return or perhaps a negative return in order to get the benefit of the inflation hedge, would he not?

A. No, sir, because a part of the inflation hedge is the income that he derives from the investment.

Q. If his capital investment were guaranteed against [of 8767] inflation, would he require any income, in your opinion?

A. My opinion is that the vast majority of investors would want income from a security which they bought for the purpose of hedge against inflation.

Q. But that income would be much lower, would it not, than if he had no guarantee against inflation? In other words, he would be willing to accept a considerably lower return on his investment if the investment were, itself, guaranteed against inflation. Is that correct?

A. When you speak of having his principal guaranteed against inflation, I presume you mean that someone guarantees to this investor that the amount that he invests in this given security is going to appreciate at the same rate as, let us say, for simplicity, cost of living.

Q. What I am saying is precisely that, to-wit, that he will be guaranteed that his investment will continue to buy the same amount of bacon and eggs five years from today, for example, as that amount of bacon and eggs which he can purchase today with present day dollars.

A. Well, in my viewpoint an investor does not buy bacon and eggs with principal, he buys it with income

and, consequently, the income, the rate of income, would have to be guaranteed to increase in the same proportion as the cost of living increases in order that he can buy out of income as much bacon and eggs at the peak of the [fol. 8768] inflation as he could when he bought the investment.

Now, that implies a rapid increase or a rise, at any rate, in the ratio of income to his original purchase cost.

By Mr. Littman:

Q. Does the investor in Government bonds have a hedge against inflation?

A. Generally speaking, no, but there is one issue of Government bonds in which there is a moderate hedge against inflation.

Q. Which one is that?

A. That is the U. S. Savings Defense Series G, 2 1/2% due in 12 years, selling at par, under the terms of which there is set up a retirement schedule according to which the Government agrees to buy back the bonds at a given price, according to the time, from the original investor upon his demand. That is so framed that if interest rates should, because of inflation or for any other reason, rise to 5 percent, he could bring demand on the United States Government and get his money back at a discount, the maximum discount being a price of \$94.70 per \$100 and [fol. 8769] reinvest at the higher rate.

To a degree that is a hedge against inflation, but that is the only one I know of in the Government list.

Q. That is a very minor hedge against inflation, is it not?

A. It is a very important hedge for a 12-year period and it is so important to the trust companies of the United States that millions upon millions of dollars are being invested in those U. S. 2 1/2% Series G.

Trial Examiner: Incidentally, that is a novel development, Mr. Drew, in ultimate finance?

The Witness: Yes, sir, as far as I know it is the first of its kind in our country.

By Mr. Littman:

Q. That is; however, not a complete hedge against inflation, is it?

A. I stated before, I think, that there is no such thing as a perfect or complete hedge against inflation.

Q. If I had deposited dollars in your bank in 1936 and I withdrew them on November 12, 1941, would my withdrawal be scaled up or down because of the change in the purchasing power of the dollar between those two periods?

A. Well, I am not an economist, but in answer to that question I should say that you would get the same kind of dollars when you withdrew as when you deposited. I [fol. 8770] should say, further, that the dollars that you withdrew would buy fewer commodities than those which you deposited, simply because I believe the average of commodity prices has risen during that period.

Q. The same is true of life insurance, isn't it?

A. A similar thing, yes. Of course, life insurance is paid for over a long period of years and usually pays out in a lump sum, it is a little different kind of thing.

Q. What rate of interest does your bank pay on these deposits which are not, of course, as you say, guaranteed against inflation?

A. Now, when you ask me that question, Mr. Littman, you are referring to our commercial deposits or our trust accounts?

Q. Your commercial time deposits.

A. Well, the savings account rate is $1\frac{1}{2}$ percent and the commercial deposits by commercial corporations receive no interest payments by law.

Q. Now, Mr. Drew, if you were to guarantee your savings accounts against inflation, you would, in all probability, not pay any interest, would you?

A. Well, I find it hard to conceive that any such guarantee would ever be given.

Q. Well, if you can conceive of such a guarantee, and a certain witness in this case has conceived it with respect to Michigan Gas Transmission Corporation, you would not have to pay any interest to attract depositors, would you?

A. I see what you mean.

Q. You would not have to pay me any.

A. Well, I would just dislike to answer such a question that is so far from the realm of possibility in the banking field. ♦

♦ ♦ ♦ ♦ ♦ ♦ ♦ ♦

[fol. 8821] ROBERT S. DREW a witness, having been previously duly sworn, resumed the stand and testified further as follows:

Cross-Examination (Continued)

The Witness: Mr. Littman, may I make a comment or two having to do with the subject we were discussing before the noon recess?

By Mr. Littman:

Q. Yes.

♦ ♦ ♦ ♦ ♦ ♦ ♦ ♦

[fol. 8824] The Witness: Then, may I make one more comment with respect to our discussions of these [fol. 8825] 50 bonds? I got the impression from your questions that you feel that the smaller the ratio of the bond issue to the total capitalization, the cheaper and the more economical can be the financing of the entire company. If my impression is correct, I should like to say that I think you are not correct in that position because in time of low bond interest rates, it is obvious that the larger proportion of a capitalization which you can finance by bonds, the more economical is going to be the over-all cost of financing a company and while with a lower proportion of [bonds] there would be a correspondingly larger issuance of stock with less bonds proportionately ahead of it, yet, in spite of that, my firm conviction is that the over-all cost of such a financing job, namely, 25 percent bonds, 75 percent common stock, would be considerably more expensive and less economical than would the 50-50 ratio.

By Mr. Littman:

Q. You have testified heretofore that you used as the average market price of the common stock of Panhandle Eastern the sum of \$40 per share, is that correct, in determining the over-all appraisal of risk of the investor?

A. Well, Mr. Littman—

Q. (Interposing). Is that right?

A. In my direct testimony I included the four companies which I used in determining the average of the in- [fol. 8826] vestor's appraisal of risk but I excluded Panhandle Eastern from that study. It was during the cross-examination Friday that I spoke of the Panhandle Eastern study and I did use \$40 as the price of the common stock.

Q. Yes, I believe it was in response to a question by Mr. Lee.

A. Yes, sir, I think so.

Q. And you consider the \$40-per-share price for Panhandle Eastern a reasonable estimate of the market price?

A. I considered it so at the time I made the study which was at the same time that I studied the other four companies, namely, the latter part of October and early November and I considered that \$40 was reasonable at that time. The present market price of the stock is around \$35 to \$36.

Q. But at the time you made your study, last September or October, you considered \$40 per share as the fair market value of the common stock of Panhandle Eastern?

A. Yes, sir.

Q. Now, do you know what the earnings were on that common stock per share for the 12 months ended June 30, 1941, which was the latest available full 12-month period at the time you made your study? I hand you Mr. Coffman's Exhibit No. 65 and refer you to his table for Chart No. 20.

A. Yes, sir.

Q. What were the earnings per share?

[fol. 8827] A. \$4.21 per share.

Q. Now, will you please state the earnings-price ratio based upon the earnings per share of common which you have just read and the market value of \$40 per share?

A. Approximately 10½%.

Q. Percent?

A. Percent, yes, sir.

[fol. 8853] By Mr. Littman:

Q. In your study you considered the earnings of four natural gas companies, to wit, Interstate Natural Gas Company, El Paso Natural Gas Company, Memphis Nat-

ural Gas Company and Southern Natural Gas Company did you not? A. Yes, sir.

Q. Have you made any study to determine whether the securities of those companies are selling at approximately an amount equal to a rate base for rate making purposes?

A. No, sir, I have not.

[fol. 8854] Q. Just answer that yes or no, please. Did you or did you not? A. I did not.

Q. So far as you know, they might be selling at five times what a commission or court would consider a rate base for rate making purposes?

A. That is correct.

Trial Examiner: And Mr. Drew has also previously testified, if I recall, that he had no knowledge of the book value of either of these companies that he included or included in the study.

The Witness: Yes, sir, that is correct.

Trial Examiner: The original cost as represented or reflected by the books of the company, the capital account

[fol. 8887] LEITH V. WATKINS a witness having been previously sworn, resumed the stand and testified further as follows:

Direct Examination (Resumed)

By Mr. Wheat:

[fol. 8895] Q. Yes. Then will you proceed to the next item?

A. At page No. 859 of the transcript of proceedings in this matter of October 8, 1941, there was received and marked for identification Exhibit No. 48.

Q. What was the title of that exhibit, Mr. Watkins?

A. Exhibit No. 48, as received for identification, comprised the balance sheet, per books, of Panhandle Eastern Pipe Line Company and subsidiary companies for each December 31 from the year 1930 to and including the year 1940 and as at June 30, 1941.

[fol. 8896] Q. Have you, since the presentation of that exhibit and since the passage of time, been able to complete the balance sheet with respect to the year 1941?

A. I have and it was so completed in conformity with the witness' interpretation of a request made by Mr. Gorman, counsel for the Commission, at page No. 7444 of the transcript of testimony in this matter.

Q. Have you prepared an exhibit showing balance sheets, per books, for the years 1930 to and including the year 1941 in a form similar to the form shown on Exhibit No. 48 but including the full year 1941, from the books of the company? A. I have.

Q. And is that one of the proposed exhibits which you have had distributed this morning?

A. It is.

Mr. Wheat: ME, Examiner, this three-page exhibit which is entitled "Balance Sheets—Per Books" of course is referable to Exhibit No. 48 and in all respects is similar to Exhibit No. 48 with the exception that, for the year 1941, the balance sheet as of the close of that year is taken from the books and, therefore, this exhibit contains no estimates with respect to that year nor does it contain a balance sheet as of June 30 of that year.

[fol. 8897] (The Document Referred To Was Marked For Identification As Exhibit No. 172.)

[fol. 8898] (Exhibits Nos. 48 and 172 Were Received In Evidence.)

A. At page 871 of the transcript of proceedings in this matter of the session of October 8, 1941, there was received and marked for identification, Exhibit No. 49. Exhibit No. 49 was an income statement, per books, of Panhandle Eastern Pipe Line Company and subsidiary companies covering the period from April 1, 1932, to December 31, 1941; and the information there shown was as of December 31, 1932, and covered the period from April 1 of that year. There was also included the income statement

for the calendar years 1933 through 1940, both inclusive, as well as a cumulative total, an average for the period from 1932 to 1940 and the year 1941 which, however, was made up of six months actual figures and six months estimated figures.

Q. Have you, during the interim since the last hearing, prepared an exhibit which may be deemed referable to this Exhibit No. 49 which you have been describing but which includes, instead of the six months actual and six months estimated for the year 1941, an income statement from the books for the year 1941? A. I have.

[fol. 8899] (The Document Referred To Was Marked for Identification As Exhibit No. 173.)

Trial Examiner: The exhibits marked for identification as No. 49 and No. 173 will be received in evidence by corresponding numbers.

A. At page No. 890 of the transcript of the proceedings [fol. 8900] in this matter, held on October 8, 1941, Exhibit No. 50, being a statement of earned surplus, per books, for a period from the commencement of operations to June 30, 1941, was offered and received in evidence—I beg your pardon, I believe it was offered and marked for identification.

Q. That is correct. It was marked Exhibit No. 50 for identification, I believe.

A. That is correct, sir. Since the witness' last appearance and, in conformity with a request made by Mr. Gorman, counsel for the Commission, at page 7444 of the transcript of a previous session in this matter, there has been prepared under my supervision a similar statement which includes an analysis of earned surplus for all of the period included in Exhibit No. 50 with the exception that the data for the year 1941 covers the entire year rather than the period from January 1 to June 30 of 1941.

(The Document Referred To Was Marked For Identification As Exhibit No. 174.)

[fol. 8901] (Exhibits Nos. 50 and 174 were received in evidence.)

By Mr. Wheat:

A. The next item upon which we have been working during the interim conforms to Exhibit No. 51 offered and received for identification at page 893 of the transcript of the proceedings in this matter held on October 8, 1941, and is a statement of capital surplus, per books, for the period from September 1, 1930, to December 31, 1941.

It contains exactly the same information as Exhibit No. 51 except that column M covers the entire year 1941 rather than the period from January 1 to June 30, 1941, and is responsive to a request made by Mr. Gorman, counsel for the Commission, at page No. 7444 of the transcript of the proceedings.

[fol. 8903] Mr. Wheat: And we also offer Exhibit No. 51 and Exhibit No. 175 in evidence.

[fol. 8904] (Exhibits Nos. 51 and 175 were received in evidence.)

There was offered, received and marked for identification at page No. 896 of the transcript of the testimony in this matter, session of October 8, 1941, Exhibit No. 52. Exhibit No. 52, as received for identification, comprised a statement of gas plant of Panhandle Eastern Pipe Line Company and subsidiary companies as at December 31, 1930, and at the end of each year thereafter up to and including the year 1940 and as of June 30, 1941.

In response to our interpretation of the request made by Mr. Gorman, counsel for this Commission, at page No. 7444 of the transcript of a previous session in this matter, there has been prepared and is available a statement of gas plant which is exactly the same as Exhibit No. 52 except that Column M thereof furnishes information as at December 31, 1941, whereas, in the case of Exhibit No. 52, the information shown in Column M was as of June 30, 1941.

[fol. 8905] (The document referred to was marked for identification as Exhibit No. 176.)

(Exhibits Nos. 52 and 176 were received in evidence.)

Q. Will you proceed to your next item, Mr. Watkins?

A. There was offered and received for identification at page No. 915 of the transcript of the proceedings in this matter on October 8, 1941, Exhibit No. 56. Exhibit No. 56, as there received and identified, consisted of a statement of gas produced for the period from April 1, 1932, to June 30, 1941, giving the amount of production segregated as to the various fields and by total for the years 1933 to 1940, inclusive, for the nine months April 1 to December 31, 1932, and for the year 1941, in which instance the data shown covered the six months period only.

Q. What have you done during the interim?

A. This exhibit, likewise, included the cumulative totals and an average for eight and three-quarters years. In [fol. 8906] the interim, in response to a request made by Mr. Gorman, counsel for the Commission, at page No. 7444 of the transcript of testimony in a preceding session in this matter, there has been prepared a revised "Statement of Gas Produced" which furnishes exactly the same information as that included in Exhibit No. 56 except that the production for the entire year 1941 is shown.

(The Document referred to was marked for identification as Exhibit No. 177.)

(Exhibits Nos. 56 and 177 were received in evidence.)

(Exhibits Nos. 53, 54 and 55 were received in evidence.)

[fol. 8907] A. The next item, sir, is a "Statement of Gas Purchased" which extends the information included in Exhibit No. 57, received and marked for identification, at page 916 of the transcript of the proceedings in this matter on October 8, 1941, and furnishes information similar to that included in Exhibit No. 57 except that it has been progressed through December 31, 1941, and the appropriate changes necessary to accomplish that projection have been made.

(The document referred to was marked for identification as Exhibit No. 178.)

(Exhibits Nos. 57 and 178 were received in evidence.)

[fol. 8919] At page 917 of the transcript of the testimony of the session of the proceedings in this matter on October 8, 1941, there was offered and marked for identification Exhibit No. 58. Exhibit No. 58 consisted of a "Statement of Gas Revenue" for the period from April 1, 1932, to June 30, 1941.

In response to the request made by Mr. Gorman of counsel for the Commission at page No. 7444 of the transcript of the testimony of a preceding session of this matter, there has been prepared a summarized statement of gas revenue which progresses the information included on Schedule 1 of Exhibit No. 58 through the year 1941.

(The document referred to was marked for identification as Exhibit No. 179.)

[fol. 8911] (Exhibits Nos. 58 and 179 were received in evidence.)

Mr. Littman: Mr. Watkins, you show several columns, to wit, Columns H, I and J in Exhibit No. 179 headed "Industrial". Is my understanding correct that those sales represent all of the direct industrial sales for those years?

Mr. Littman: In other words, your columns headed "Sales to Gas Utilities" include the so-called indirect industrial sales?

Mr. Littman: And by direct industrial sales, of course you understand me to mean the sales that are made directly by Panhandle Eastern Pipe Line Company and subsidiary companies in each of the years shown directly to the various industrials included under columns headed H, I and J?

The Witness: Yes, I so understand and that, as far as I know, is what those columns show.

Mr. Wheat: Mr. Littman, may I ask you whether you [fol. 8912] don't want to go forward and clarify also the columns headed "Residential" and "Commercial" as to whether those are direct or indirect so that we will have a clear picture of what this shows?

Mr. Littman: Very well, but before so doing, I would like the record to show clearly what we mean when we use the term "direct." By that we mean sales not for resale, isn't that correct?

The Witness: That is correct. Mr. Littman, the witness believes that reference to the testimony at or about page 917 would probably show that this matter had been covered there when the exhibit was originally introduced.

Mr. Wheat: You mean in Exhibit No. 58?

The Witness: That is correct, yes.

Mr. Littman: Yes, I recall that testimony, having read it recently, but I wanted to make certain the new figures contained in Exhibit No. 179 for the full year 1941 were shown in the same manner here in Exhibit No. 179 as in Exhibit No. 58.

The Witness: They are.

Is it possible that the thing that may be worrying you, Mr. Littman, is the fact that on or about July 1, 1941, both Panhandle Eastern Pipe Line Company and Michigan Gas Transmission Corporation filed certain rate schedules for sales in the State of Indiana by the terms and provisions of which Panhandle Eastern would begin the direct sales of certain gas in that State whereas, prior to those rate schedules, Michigan Gas Transmission Corporation had made such sales itself? There has been no action taken on those filings in all of this period by the Commission. As far as we know, there is some matter that gives rise to consideration on the Commission's part as to the termination of service in connection with those matters. It has been somewhat troublesome to us to have the thing unsettled all this period and it may very well be that, as a result of whatever pronouncement the Commission makes with respect to those filings, some of the material now included in Exhibit 179 with respect to the year 1941 would have to be changed if the rulings of the Commission make such change necessary.

I do not know whether that was the thing that prompted your questions or not because there can be no sales included in Exhibit No. 58 or Exhibit No. 179 as direct sales other than in the columns corresponding to the headings "Residential", "Commercial", "Industrial" and "Other".

Mr. Littman: What prompted my question, primarily, was the fact that the Federal Power Commission has no jurisdiction over sales not for resale, that is, over direct sales, and I wanted to make certain that your Columns

H, I and J represented the direct sales and did not represent sales for retail.

In connection with Mr. Wheat's suggestion, will you elaborate for us with respect to the columns headed "Residential" and "Commercial"?

[fol. 8914]. The Witness: Perhaps we would save time if the witness simply stated that, outside of Columns K, L and M which have to do with sales to gas utilities, all of the gas revenue shown in either Exhibit No. 58 or Exhibit No. 179 represents direct sales.

By Mr. Wheat:

Q. Mr. Watkins, while we are right on this point, I notice that under the heading "Residential", Column I, for example, "Amount", it is reduced from \$186,018.44 in 1940 to \$9,446.77 in 1941. That represents a very extensive shrinkage in that direct residential business, does it not?

A. That is correct.

Q. And, likewise, under the heading "Commercial", take for example Column G, the amount reduces from \$76,497.50 in 1940 to \$290.39 in 1941. That represents, does it not, an almost complete shrinkage of that particular type of sale? A. It does.

Q. Likewise, under the heading "Other", take for example Column P, the amount reduces from 1940, when it was \$8,098.95 to an amount in 1941 of \$327.50 and that is likewise an almost complete shrinkage of the item, is that not correct? A. That is correct.

[fol. 8915]. Q. And, in 1941, except for the direct industrial sales, the total sales which were made direct by the company were less than \$10,000, is that not true?

A. That is true, yes, sir.

I might explain that the reason for this shrinkage is due to the fact that as of January 1, 1941, Central Distributing Company ceased to be a subsidiary of Panhandle Eastern Pipe Line Company and the shrinkage in sales which you have just described were sales made directly by Central Distributing Company:

Q. So that, as a practical matter, compared to the total revenues, the amounts received from direct sales other than industrial are negligible, is that not true?

A. They are almost insignificant in addition to being negligible.

[fol. 8921] Mr. Lee: And these residential sales, for example, that are on the exhibit and are listed as direct sales, is that gas sold to a distribution company or sold direct to residential users by the Pipe Line Company?

The Witness: Panhandle Eastern Pipe Line Company and Illinois Natural Gas Company, which are the two main transmission organizations and have been the two main transmission organizations in the Panhandle system, do not hold themselves out as distributing organizations. There are, over the length of our lines, certain instances in which, as a matter of convenience and by virtue of right-of-way agreements and so forth, that both of those organizations make some incidental sales to certain residential or commercial customers and a good part—

—Mr. Culton: (Interposing) Just a moment. May we clarify that for the record. That means when you would get a right-of-way across a man's land, as part of the consideration for that right-of-way, you would agree to sell him gas?

The Witness: Exactly so, sir.

Mr. Culton: For his residence on the farm.

The Witness: Otherwise, we have no interest whatever in such sales and we might go a step further, perhaps, and [fol. 8922] state that were it not compulsory that we make such sales, we would have none whatever in an exhibit of this sort that we furnished.

In further explanation of your question, Mr. Lee, the reference to revenue shown in Columns N, O and P under the general heading of "Other" is principally to sales made in the field in the producing field where we supply gas for drilling purposes or things of that nature.

Mr. Littman: Pardon me, I believe you perhaps mis-spoke yourself somewhat with respect to these residential sales. Shouldn't your last answer be confined to the year 1941? As I understand it, prior to 1941, Panhandle Eastern Pipe Line Company owned a number of subsidiary companies that were actually engaged in the business of distributing gas and isn't it a fact that in the years prior to 1941 shown in Exhibit No. 179, your Columns B, C and D under the heading "Residential" do show those sales and revenues?

The Witness: They do show those, Mr. Littman, and I was hopeful that my most recent answer confined itself entirely to Panhandle Eastern and Illinois Natural. I had no intention of making any reference to the years prior to the last year in which years there were subsidiaries which did have direct sales.

Mr. Littman: I think the record is clear now.

[fol. 8927] Trial Examiner: This exhibit, which has been discussed, will be marked as Exhibit No. 180 and that is a supplementary exhibit to one marked for identification as Exhibit No. 59?

Mr. Wheat: That is correct, is it, Mr. Watkins?

The Witness: That is correct except we have not discussed it yet.

Mr. Wheat: Yes, we have not yet come to that but we are about to come to it.

That is headed, is it not, Mr. Watkins, "Statement of Gas Revenue by States—Period from April 1, 1932, to [fol. 8928] December 31, 1941"?

The Witness: That is correct, sir.

(The document referred to was marked for identification as Exhibit No. 180.)

By Mr. Wheat:

Q. Is that document referable to Exhibit No. 59?

A. It is, sir, and has been prepared in response to our interpretation of a request made by Mr. Gorman, counsel for the Commission, at page 922 of the transcript of the testimony of the session of October 8, 1941, in this matter.

(Exhibits Nos. 59 and 180 were received in evidence.)

A. The witness' next item is a statement showing "Net [fol. 8929] Additions to Gas Plant—Per Books" of Panhandle Eastern Pipe Line Company and subsidiary companies from October 1, 1938, to December 31, 1941, and is similar in content to Exhibit No. 72 offered and received for identification at page No. 1470 of the transcript of the proceedings in this matter of the session held October 28, 1941, the difference between the two exhibits being only that of the period covered by them.

(The document referred to was marked for identification as Exhibit No. 184.)

[fol. 8930] (Exhibits Nos. 72 and 181 Were Received in Evidence.)

Q. Will you proceed to the next item, Mr. Watkins?

A. Before doing so, Mr. Wheat, may the witness call attention to the fact that the cessation of Central Distributing Company as a subsidiary of Panhandle Eastern Pipe Line Company is shown by the reduction in the additions to gas plant shown opposite lines 17 and 28 in Exhibit 181.

Q. Those are distributing system properties, are they not?

A. That is correct, sir. There may have been a very slight amount of such property belonging to some other one of the companies but I should say almost 100 per cent of it represented distribution properties belonging to Central Distributing Company.

Q. In every instance, the amounts shown under Column B are net amounts, whether they be black or red amounts, is that correct?

A. That is true, sir, and that explanation, I believe, was given at the time Exhibit No. 72 was introduced.

Q. Before we pass to further documents, Mr. Watkins, do you have Exhibit No. 60 before you?

A. Yes, sir.

[fol. 8934] Q. Will you state the title of Exhibit No. 60, Mr. Watkins?

A. The title of Exhibit No. 60 is "Gas Sales Agreements with Other Gas Companies as at June 30, 1941."

(Exhibit No. 60 Was Received in Evidence.)

A. The next document which has been distributed is a "Comparative Statement of Depreciation, Depletion and Amortization of Unoperated Leases Authorized by Board of Directors and the Amount Booked for the Years 1937, 1938, 1939, 1940 and 1941", and is responsive, the witness believes, to a request made at page No. 6237 by Mr. Goodman during the afternoon session of the proceedings in this matter on January 21, 1942.

Q. Will you state what this document shows?

[fol. 8932] A. This document, as its heading indicates, gives a comparison of the annual provision for depreciation, depletion and amortization of unoperated leases by the Board of Directors with the amount recorded on the company's books for the years 1937 through 1941, inclusive.

The comparison for the year 1937, as shown by line 1, is \$1,350,000 authorized and \$1,384,387.07 is recorded; per books.

For the year 1938, as shown by line 2, the amount authorized by the Board was \$1,700,000, the amount recorded being \$1,728,607.16.

For the year 1939, as shown by line 3, the amount authorized was \$1,800,000 and the amount recorded was \$1,870,699.86.

In 1940, as shown by line 4, the Board authorized \$1,900,000 and there was recorded \$1,880,889.87.

Finally, for the year 1941, as shown by line 5, the authorization was \$2,100,000 while the amount recorded was \$2,102,857.31.

(The Document Referred to was Marked For Identification as Exhibit No. 182.)

[fol. 8933] (Exhibit No. 182 Was Received in Evidence.)

[fol. 8934] By Mr. Wheat:

Q. Will you now turn to your next document and state what it is, at whose request it was made, if anyone's, and what the request was?

A. Perhaps I had better look at the transcript of testimony first.

There has been prepared and distributed a "Statement Showing the Amount of Depreciation Claimed in Federal Income Tax Returns and Settlement Basis for the Nine Months Ended December 31, 1932, and the Years 1933 to 1940, Inclusive."

This statement, as its heading shows, gives for the nine months ended December 31, 1932, and the years 1933 [fol. 8935] through 1940, the amount of depreciation claimed per Federal income tax returns and the so-called settlement basis therefor in the years described and specifically shown by the exhibit. It is in response to a request made at page No. 6239 of the transcript of the proceedings of the afternoon session of January 21, 1942, made by Mr. Goodman.

Mr. Lee: Mr. Witness, may I ask you, please, what you mean by the term "settlement basis"?

The Witness: Well, of course as you know, Mr. Lee, you do not just simply file an income tax return and proceed to pay your tax without the Internal Revenue Department having looked at the return.

As a result of their examination of the return, there arises some considerable discussion as to whether the findings they make in favor of revenue or in favor of the company are proper and legitimate and, as a result of the difference there may be between the company's representatives and the representatives of the Department, you eventually arrive at some basis of settlement. Whether or not you concede or believe that the contention of the Department is correct or whether they believe your contention is correct, there is a settlement made.

For the years 1936 through 1940—and they, by the way, are the only years in the history of Panhandle Eastern and its subsidiary companies in which there was taxable net income—the amounts shown in the columns headed [fol. 8936] "Settlement Basis" or Column C of—has it been numbered?

(The Document Referred to was Marked For Identification as Exhibit No. 183.)

Mr. Wheat: You were speaking of Column C of Exhibit No. 183?

The Witness: That is correct, sir, and the amounts shown in Column C of Exhibit 183 are, as far as the company knows at this particular time, the basis of its present settlement with the Internal Revenue Department of the taxes for those years.

Mr. Lee: After that settlement is made, then do you enter that upon the books of the company as the final determination?

The Witness: It becomes entered, Mr. Lee, in the normal accounting processes of the company. If you were to refer to previous testimony by this witness, you would find that there have been certain accruals made in prior years, not ultimately required for taxation which were transferred to an account shown on Exhibit No. 148 on line 36 in Columns I, J, K, L and M which represented, as the witness has stated and stated in the previous sessions, were not required for that particular purpose.

Perhaps, to narrow the thing down and answer you more directly, if the company's accrual for Federal taxes [fol. 8937] or any other taxes or for any other purpose is not sufficient in the year for which those taxes are reported, it must, of course, increase its accrual in some subsequent period or it must decrease it. As these settlements are made, if the differences are such as not to distort the operations of the current year in which they are made, they are adjusted in the operating expenses of that year's business. Under the Classification of Accounts, prescribed by this Commission for natural gas companies, the treatment which the witness has just described is prescribed.

[fol. 8938] Mr. Littman: I would like to ask a question to clarify the exhibit, if I may.

Mr. Watkins, will you define the term "depreciation", as it is used in Exhibit No. 183?

The Witness: We will have to get a copy of the income tax return, Mr. Littman, for each of those years. It is the amount required to be reported as depreciation in the returns.

Mr. Littman: Does it include and do the figures shown in Exhibit No. 183 include any claimed amortization of gas sales and purchase contracts?

The Witness: May I suggest that you have a look at Exhibit No. 182 along with Exhibit No. 183.

In Exhibit No. 182 in Column B, you will find, for the year 1941, that the Board of Directors authorized an overall provision for depreciation, depletion and amortization of \$2,100,000. Now, this \$2,100,000 did not include any [fol. 8939] amount which the company proposed to include in its operations for that year and amortization of any amounts included in its books as gas sales or purchase contracts; the reason for that being because, in the first instance, the Certificate of Incorporation of the company provides for the amortization over a ten year basis of certain of the gas sales and purchase contracts at the rate of \$24,419.05 per month.

The amounts associated with the gas sales and purchase contracts acquired subsequent to the entering into a contract with Detroit City Gas Company, now Michigan Consolidate Gas Company, are being written off, as the record here will show in previous testimony, over the life of those contracts. None of that amortization is included, either in the \$2,100,000 figure made a part of Column B of Exhibit 182 or Column C of the same exhibit and, in the year 1941, of course, we have not yet completed our income tax returns so I cannot give you comparable figures but, whatever is required by the Revenue Department to be reported as depreciation according to the definition in the income tax return, will be grouped together and there reported as depreciation. The definition is not our language.

We were asked at page No. 6239 of the transcript of the testimony of the afternoon session on January 21, 1942, to produce a statement showing depreciation claimed per returns and the settlement basis and that information we believe, [fol. 8940] lieve is shown in Exhibit 183. Unfortunately, I do not have with me the income tax returns and cannot tell you, specifically, just what items are included, for instance, in the amount of \$2,381,293.48 in Column B of Exhibit No. 183 on line 8 but, referring to an amount appropriated or authorized by the Board for the year 1940 and shown in Column B of Exhibit No. 182, it is my opinion that the amount shown in Column B on line 8 of Exhibit 183 not only includes certain amortization but an entirely different basis than that either authorized by the Board or booked because the depreciation claim for income tax purposes does not necessarily coincide in this instance, with the amounts recorded.

[fol. 8944] (Exhibit No. 183 Was Received In Evidence.)

The next document prepared for the present hearing is a "Comparative Statement of State, Local and Miscellaneous Federal Taxes Paid with Amounts Accrued for the Years 1936, 1937, 1938, 1939 and 1940".

[fol. 8948] (The Document Referred To Was Marked For Identification As Exhibit No. 184.)

A. Exhibit No. 184 for identification was prepared in response to a request occurring at page 6239 of the transcript of the afternoon session of the proceedings in this matter held January 21, 1942, made by Mr. Goodman and shows, for the respective years, the amount of taxes accrued and taxes paid as well as the difference between the accruals and payments of all State, local and miscellaneous Federal taxes and seems self-explanatory.

(Exhibit No. 184 Was Received In Evidence.)

[fol. 8949] The next document is a "Statement of Taxes Paid for the Years 1936, 1937, 1938, 1939 and 1940" which was requested at lines 11, 12 and 13 of page No. 6364.

(The Document Referred To Was Marked For Identification As Exhibit No. 185.)

[fol. 8952] The Witness: Exhibit No. 185 is a statement of taxes paid for the respective years shown there regardless of when paid.

Mr. Littman: Perhaps it would further clarify the matter if you would explain why you have not shown this statement for the year 1941?

The Witness: All such taxes have not yet been paid and could not, therefore, be shown.

[fol. 8954] (Exhibit No. 185 Was Received in Evidence.)

A. The next document is a "Reconciliation of Federal Income and Federal Excess-Profits Taxes Paid with the

Amounts Accrued for the Years 1936, 1937, 1938, 1939 and 1940", and is in response to an oral request made to you, Mr. Wheat, by Mr. Littman, counsel for the Commission, on or about March 9, 1942.

[fol. 8955] (The Document Referred To Was Marked For Identification As Exhibit No. 186.)

(Exhibit No. 186 Was Received In Evidence.)

[fol. 8975] By Mr. Wheat:

Q. Now, Mr. Watkins, will you turn to your next document and state what it is?

A. The next document is a "Comparative Statement of Operation and Maintenance Expenses" of Panhandle Eastern Pipe Line Company and subsidiary companies for the years ended December 31, 1940, and 1941 and consists of a proposed exhibit containing four pages.

(The Document Referred To Was Marked For Identification As Exhibit No. 190.)

The Witness: This Exhibit No. 190 has been prepared and is submitted in response to a request made by Mr. Gorman, counsel for the Commission, at page No. 7444 of the transcript of a preceding session in this consolidated matter.

Q. And what do the numbers shown in this exhibit prior to the titles of the various accounts indicate?

A. The numbers immediately succeeding the line number?

Q. Yes.

A. They are the account numbers prescribed by this Commission in its Classification of Accounts for natural gas companies subject to the Natural Gas Act. The title [fol. 8976] likewise is the name of the account prescribed in such classification.

(Exhibit No. 190 Was Received In Evidence.)

Mr. Littman: I would like to ask Mr. Watkins about one or two items which appear on page 4 of Exhibit No. 190.

Mr. Watkins: I call your attention to an item shown in line 8 on page 4 called "Special Services" in the sum of \$19,572.84 for the year 1940 and in the sum of \$22,358.80 for the year 1941. Can you inform us with respect to the character of those services?

The Witness: I have no specific information available at this time with respect to the two amounts to which counsel has just referred other than the fact that the charges made to this account, No. 795; the title of which is "Special Services" conform to the description for such account as given on page No. 131 of the Uniform System of Accounts prescribed for natural gas companies by the Federal Power Commission.

Mr. Littman: Can you enlighten us with respect to the items shown on line 9 of page 4 of Exhibit No. 190 entitled "Special Legal Services" in the amount of \$76,018.19 for [fol. 8977] the year 1940 and \$53,322.07 for the year 1941?

The Witness: The witness' response to that question, Mr. Littman, must, of necessity, be similar to that with respect to your question concerning the amounts included in Account No. 795.

Now, without being bound too closely to this, I should like to state that it is my belief that the charges in both instances do represent the cost of either special services or special legal services in connection with matters either before the Securities and Exchange Commission or before the Federal Power Commission in those two years.

Mr. Littman: You are not referring to rate case expense?

The Witness: The cost of the regulatory commission expense incident to the Federal Power Commission consolidated Dockets G-200 and G-207 have not yet put their appearance in any of the company's financial statements other than in a deferred charge on its balance sheet. The distribution of those costs to operating expenses began first with the month of January, 1942.

Mr. Littman: Will you endeavor to ascertain the nature and character of the expenses which we have just discussed and report back to us at your early convenience? I have in mind that possibly you can find out something about this account over the recess.

[fol. 8978] The Witness: If all you want is a general statement with respect to their content, I believe that can be accomplished and I do not believe it will vary from the explanation I gave a moment ago and asked not to be specifically bound to.

[fol. 8988] LEITH V. WATKINS a witness, being previously duly sworn, resumed the stand and testified further as follows:

Direct Examination (Continued).

By Mr. Wheat:

Q. Mr. Watkins, have you prepared also a document entitled "Reconciliation of Net Income Per Books with Net Income Per Federal Income Tax Return for the Year 1939"?

A. I have, sir.

Q. Has that document been distributed?

A. It has.

(The Document Referred To Was Marked for Identification As Exhibit No. 191)

Exhibit No. 191 for identification is, a reconciliation of [fol. 8989] the net income per books of Panhandle Eastern Pipe Line Company with the net income per Federal income tax return for the year 1939 and is submitted in response to an oral request made by Mr. Littman of counsel for the Commission to Mr. Wheat on March 9, 1942, and if we may at this time refer to the next document—

Mr. Wheat: (Interposing) Yes.

Mr. Examiner, I suggest that the next document which is the same as Exhibit No. 191 for identification except that

it refers to the year 1940 be marked for identification Exhibit No. 192.

(The Document Referred To Was Marked For Identification As Exhibit No. 192.)

As the witness was about to state, both of these documents have been prepared and are submitted in response to an oral request made by Mr. Littman of counsel for the Commission to Mr. Wheat on March 9, 1942. It is believed the two reconciliations are self-explanatory. However, if there be questions, the witness—

Q. (Interposing) I think, Mr. Watkins, you might explain briefly what is shown on these two documents and [fol. 8990] how the data was developed.

A. The two documents marked for identification as Exhibit No. 191 and Exhibit No. 192 begin with the statement of the net income per books for the years 1939 and 1940, respectively. These amounts are then adjusted by adding thereto certain provisions made on the company's records which are not allowable deductions for Federal income tax purposes and the amount so arrived at is then reduced by a series of deductions determined on the formulae and bases provided in the regulations with respect to the Federal income tax laws for the years 1939 and 1940 and thus finally arrive at the net income per the Federal income tax returns for those years, as adjusted, by the Bureau of Internal Revenue. That is true for the year 1939.

However, for the year 1940, the income and excess profit tax returns have not been completely examined by the Bureau of Internal Revenue. Its representatives are in the office of the company at this time in connection with the examination for the year 1940.

[fol. 8994] Mr. Littman: Mr. Watkins, I note from Exhibit No. 192, lines 22 and 23, that your deduction for income tax purposes for depreciation exceeded the book provision by \$745,162.16 for the year 1940 as compared with

the similar item in Exhibit No. 191 for the year 1939 in the amount of \$1,205,356.

Will you explain why there is such a great difference between the excess of deduction claimed for depreciation over look provision as between 1939 and 1940?

Mr. Wheat: Have you, Mr. Littman, by any chance consulted Exhibit No. 183 in that connection? I am not sure that would convey the answer but it might be helpful to consider it in connection with your question.

I am not sure, Mr. Watkins, that the answer to Mr. Bittman's question is there but I thought possibly we might suggest that the items be considered in your explanation.

The Witness: Gentlemen, I had hoped that I would save complicating this matter by the avoidance of any explanation to you as to the fact that, in the determination of our net taxable income and the arrival at a basis for the proper deduction for depreciation, depletion and amortization over the years in which we first had net taxable income [of \$995] come, that we had employed the so-called wasting assets method and, in making our filings up to date with the exception of the year 1940 and with the exception of the return for the year 1941 which is in process of preparation, although not yet filed, our depreciation claimed is on a wasting asset theory and basis whereas the amount allowed in the settlement with the Department has been on an entirely different basis. That is quite complicated and is the explanation for the variation that you see in Exhibits No. 191 and No. 192 for identification. That is, that is the general explanation.

There may be some other factors that brought about the variation but I must again call attention to the fact that, for the year 1940 as shown by the note opposite lines Nos. 50 and 51 of exhibit for identification No. 192, the examination by the Department for that year has not yet been completed so that, in answering the oral request made to you by Mr. Bittman on March 9, we have tried to give effect in Exhibit No. 192 to the same basis of settlement as shown by Exhibit No. 191.

It is quite possible that we may have improperly handled some of the additions or deductions on exhibit for identification No. 192 because of that fact.

By Mr. Wheat:

Q. But, as a matter of fact, you have done the best you could, have you; to follow the method adopted in the settlement in 1939?

A. That is true. We have tried to outguess the revenue agents in the year 1940.

Q. May I suggest not "outguess", but "advance guess", isn't that true?

A. Either way, you wish to put it. We have tried to make the reconciliation for the year 1940 comparable to the reconciliation for the year 1939.

[fol. 9001]. (Exhibits Nos. 191 and 192 were received in evidence.)

Q. Now, Mr. Watkins, will you pass to your next document which I think is one entitled by you "Analysis of Reserve for Depreciation of Gas Plant" and state what is shown thereon?

A. Somewhere between pages 6226 and 6242 of the transcript of testimony on this matter of the session of January 21, 1942, Mr. Goodman asked for certain information with respect to depreciation. The document to which you have just referred has been prepared in response to our understanding of this request.

It shows the balance in the reserve account at the beginning of the period; the retirements classified as to production, transmission and general; the annual provision during each period, and the balance at the end of the period for the years 1932 to 1940, inclusive, and at June 30, 1941, the first page being somewhat a summary of the pages following and, on page 2, for instance, for the year 1932, there are further details given which show the cost of plant retired, the cost of removing it, the amount of salvage obtained and the net charge to the reserve account segregated as to production, transmission and general in Columns B, C and D and supplies a total in Column E.

(The document referred to was marked for identification as Exhibit No. 193.)

[Vol. 9006] Mr. Culton: Mr. Watkins, you have heretofore testified that, in your judgment, when you complete your original cost study, there will be no substantial difference between the results of that study and the values shown on the books, is that correct?

The Witness: That was my judgment.

Mr. Culton: Is that your present judgment?

The Witness: Yes, sir, and I should state at the moment that the testimony given at page 923 of the transcript of the proceedings of October 8 and in the subsequent pages of that session are compatible to the present situation.

Mr. Culton: What is necessary to be done on these original cost studies, is to apply the values shown on the books to the Commission's Classification of Accounts, is that the principal thing?

The Witness: No, indeed.

[Vol. 9007] Mr. Culton: What else is to be done?

The Witness: Well, there is set up in the Classification of Accounts itself a vast amount of work determining ~~various~~ sundry items to conform to the Commission's Classification and many studies have to be made because not a great number of the natural gas companies carried their accounts in exact conformity with the Classification prescribed by the Commission. The method in which that data is to be supplied to the Commission is set out in its Order No. 73 and Order No. 72 is a headache.

Mr. Wheat: Mr. Watkins, pardon me. When you said not many of the natural gas companies carried their accounts in the same manner prescribed by the Commission, what you meant there was, was it not, that prior to the issuance by the Commission of its Classification of Accounts, the natural gas companies which later became subject to that order were carrying their accounts according

to their own particular method and that, in many instances, those methods were not the same and could not possibly have been the same as the subsequently ordered Classification of the Commission. Is that correct?

The Witness: Yes, sir, that is correct.

Mr. Wheat: I just wanted to make that clear. I think you had a further explanation?

The Witness: I was about to draw attention to the requirements of Order No. 73, whether that need be drawn into the record here in a very elaborate way. I think the order will speak for itself. Anyone who has an interest [fol. 9008] in seeing what it requires and knowing something about how records are developed and maintained will see that it is not a thing that can be accomplished in a very short period of time.

We very studiously and laboriously went over our records and our ability to comply with the reclassification work prescribed by the Commission's Classification long before the Classification ever became an actuality because we were among those that were working with the industry and with the N. A. R. E. C. Committee toward the possible development of such a classification and we could foresee what was ahead of us. We did not exactly await until the thing was thrust in our lap and start our work but began to make our plans long before that.

We developed a list of possible major requirements, possible collateral work and began working on that. Finally, the Classification came to us and we, as the witness has stated in the record before, selected, among the ones who were going to do the reclassification work and make the studies necessary to bring about the transition from our then present method of maintaining our records to that prescribed by the Classification, the better of our employees and released those lads from any other assignment. My remembrance is that up to about July of last year, we had six or seven boys engaged in that work at a cost of some twelve to fifteen hundred dollars a month, that cost having to do entirely with his development or [fol. 9009] development of this data.

The very nature of the experience of these lads was such that when we began to develop information for use in this consolidated proceedings, we had to use some of those boys. Furthermore, you just do not go out and pick up that type of employee even if they were available, which they are not at the moment.

Trial Examiner: I do not like to interrupt this, Mr. Watkins, but the Federal Power Commission has passed on this matter of an extension and, in this hearing, it is not involved.

The question was asked whether you could supply the information with reference to certain transmission retirements and, if you are unable to do so, please so state and let us go off from there.

Mr. Culton: Mr. Examiner, may I make just a short statement here for the purposes of the record in this particular case?

Trial Examiner: You may. I am not unsympathetic, but, after all, you know we must confine ourselves strictly to what is before us in this proceeding.

Mr. Culton: This statement I shall make does have relation to this particular proceeding and that statement is this: Mr. Watkins has heretofore testified that, in his judgment, there would be no substantial difference. On behalf of the two companies, we now state in open hearing so that it cannot be thought that this delay in our studies [fol. 9010] on original cost would be used by the company in any way to try to hold up this rate proceeding, we now state we will not in these proceedings contend for an original cost any different from the original cost which shows on our books at this time.

I want the Commission to understand that and that Mr. Watkins is just referring to a physical situation which confronts him.

[fol. 9019] Trial Examiner: Exhibit No. 193 will be received.

United States of America
Federal Power Commission

Commissioners:) Leland Olds, Chairman, Basil Manly,
) John W. Scott and Clyde L. Seavey,
) Claude L. Draper not participating.

March 20, 1942

In the Matter of

Panhandle Eastern Pipe Line Company

Order denying application for Extension of time for compliance with the provisions of gas plant accounts instruction 2 D of the uniform system of accounts and the commission's Order No. 73.

The Commission having under consideration the letter of Panhandle Eastern Pipe Line Company (hereinafter referred to as Applicant) dated March 6, 1942, requesting a further extension of time to June 30, 1942, within which to comply with Gas Plant Accounts Instruction 2 D of the Commission's Uniform System of Accounts and the Commission's Order No. 73, relating thereto, and:

It appearing to the Commission from the said application and other matters of record and in the files of the Commission, furnished by Applicant, that:

(a) In a letter dated November 29, 1940, Applicant advised the Commission that its reclassification and original cost studies would be filed with the Commission during the month of November, 1941; and

(b) Thereafter, by letter dated November 27, 1941, Applicant requested an extension of time to June 30, 1942, within which to comply with the aforementioned Instruction 2 D and the Commission's Order No. 73; and

(c) By the Secretary's letter of December 30, 1941, Applicant was granted an extension of time to March 31, 1942;

(d) The reasons cited in the Applicant's letter of March 6, 1942; viz., alleged interruptions to the original (fol. 9021) cost work due to pending rate proceedings (Federal Power Commission Docket Nos. G-200 and G-207).

and certain financial transactions in connection with the acquisition of properties and issuance of securities; also, the work entailed in the preparation of Applicant's Annual Report, Form No. 133, to the Commission, do not justify, or constitute good cause for, a further extension of time.

(c) Applicant has not exercised due diligence in the preparation of its reclassification and original cost studies;

The Commission finds that:

The granting of a further extension of time to Applicant for compliance with Gas Plant Accounts Instruction 2 D and the Commission's Order No. 73 would not be appropriate and in the public interest;

The Commission orders that:

The application of Panhandle Eastern Pipe Line Company for an extension of time to June 30, 1942, within which to comply with Gas Plant Accounts Instruction 2 D of the Commission's Uniform System of Accounts and the Commission's Order No. 73, relating thereto, be and the same is hereby denied.

By the Commission,

LEON M. FUQUAY,

Secretary.

[fol. 9023] C. H. Law is a witness called by the Commission, being duly sworn, was examined and testified as follows:

[fol. 9024] By Mr. Littman:

Q. As I understand your testimony, you were given no specific instructions with respect to what you were to find or to determine at the 37 inspection points?

A. Absolutely not.

Q. And am I correct in understanding that the conclusions reached and shown in Exhibit S1 represent your judgment and the judgment of Mr. Riddle?

[fol. 9029] A. That is right.

Q. I have examined each and every one of the 37 inspection sheets shown in Exhibit S1 and I find that the condition per cents shown at each of these points are the same for yourself and for Mr. Riddle. Is my observation correct?

A. I believe you are correct. I prefer, though, to look the exhibit over myself before saying yes. There might be some variance in one or two but I am assuming you have carefully gone over it and, if that is a fact, I shall agree but, before answering the question, I think I should be privileged to look over the exhibit.

Q. Suppose you look over the exhibit and verify my understanding, if you will.

A. That is correct.

Q. I note, Mr. Lewis, that on inspection points Nos. 1 to 29, inclusive, that these inspection sheets are signed by you and initialed by Mr. Riddle and that the reverse is true with respect to inspection points Nos. 30 to 37, inclusive. Is there any particular significance to that?

A. None whatever other than that the person signing the report and the person initialing the report, that just simply means we had to have someone as a bookkeeper, you might say, on the job. Somebody had to keep the records in the field, in other words, write up the findings. The person actually making the first inspection was the person who signed the report. The person who was then [fol. 9020] standing on the ditch or on the top of the ground was recording findings as called off by the man in the bell hole or excavation, you might say.

Q. In other words, the man who recorded the data initialed the report while the other went into the bell hole and made the actual inspection and signed the report?

A. That is right.

Q. The inspection sheet for that particular inspection?

A. That is right, and it also means he followed you into the bell hole and checked your work in the bell hole on each inspection.

Q. You were the first man in the bell hole on the first 29 inspections, is that right or at least on the inspections that are numbered 1 to 29, inclusive, in Exhibit No. S1. Isn't that correct?

A. I will have to look—that is right.

Q. Did the man who did the bookkeeping and went into the bell hole merely to check, did he make as thorough an inspection as the first man in the bell hole?

A. Yes, sir, he did.

Q. And did you and Mr. Riddle each know the results of the inspection by the other?

A. By results—will you clarify that?

Q. I mean conclusions reached with respect to per cent condition?

[1. 9031] A. We did, yes.

Q. Was there a little collaboration?

A. Absolutely none.

Q. I beg your pardon?

A. Absolutely none.

Q. No collaboration?

A. I would say not. I could write my answer on a piece of paper and throw it down on the ground and Mr. Riddle could do the same thing and then, comparing the result, find there was no difference. I have done that to try to see if there would be any difference and there was none. There was absolutely no collusion. We discussed our findings after we had written down our opinions.

Q. But you each stuck to your finding at each point?

A. Well, I would say there might have been a slight variance in our opinions and it was discussed and threshed out immediately upon the ground and we came to a common agreement before we left the inspection location.

Q. As to the per cent condition?

A. That is right.

Q. In other words, it is not merely a coincidence that, at these 37 inspection points, you and Mr. Riddle arrived at precisely the same per cent condition?

A. I would not say you would term it a coincidence, no.

Q. In other words, there were some differences that [1. 9032] arose but they were threshed out after discussion? A. And very minor ones at that.

Q. Now, will you describe what you and Mr. Riddle did at these inspection points as a matter of routine and also give some description of the bell hole and the situation existing there?

A. The bell holes were already excavated prior to our arrival at the point of inspection, the bell hole being of sufficient size to permit ready access to the top, both sides and bottom of the pipe. As to the excavation below the pipe, I would judge, in most instances, at least a foot of earth had been removed which made it quite easy to examine the bottom shoulders and the bottom of the pipe.

Q. How much of the pipe was exposed at each bell hole?

A. Approximately five feet of pipe was exposed and four feet of the pipe meticulously cleaned of all scale and rust or all earth that might have adhered to the line and, in instances where the pipe was coated, the pipe coating had been removed very carefully down to a point where the metallic surface of the pipe was exposed for examination.

We measured the depth of coverage in each bell hole, that is, to the top of the pipe, and so recorded it as well as the kind of soil covering the pipe. We calipered the outside diameter of the pipe in a horizontal and vertical plane, recording our findings and we made a very careful examination of the entire surface of the pipe for pitting or corrosion that might have existed. Any pitting found was measured with an Ames dial gage reading in mils.

Q. What pitting did you record on your inspection reports?

A. The maximum pitting found was recorded, as well as the estimated average pit depth at each inspection location.

Q. You mean the maximum pit was recorded?

A. That is right.

Q. And those are expressed in hundredths of an inch, are they not? A. That is right.

Q. You may continue with your description.

A. I am about to reach the end of that description. I have told you now down to a point where the report was finished other than the application of the per cent condition. After we had examined the pipe thoroughly and it was checked by the person who acted as the recorder of our findings, he then came into the bell hole and he made the same examination and checked the findings.

After the work was completed on the pipe, I then made the photographs of all locations, with the exception, I believe, of the last eight or nine inspections on line C on the Detroit end when I was called away and was unable to accompany the Federal Power Commission engineers and Mr. Riddle during their inspection. However, as soon as I [fol. 9034] returned from Pittsburgh, I made a complete inspection of those by myself, other than company employees who were assisting me, so that made a complete survey of all 37 locations that we have recorded.

Q. I gather that you and Mr. Riddle made the same character of observations on the pipe at the various inspection points? A. That is right.

Q. And did you and Mr. Riddle follow the same method in arriving at your condition per cents? A. We did.

Q. And that method is one which is commonly called the "observation method", is it not?

A. That is right.

Q. The conclusions reached by you and Mr. Riddle with respect to the per cent condition of the main pipe lines and the lateral pipe lines of Michigan Gas Transmission Corporation are summarized on page 2 of Exhibit No. 81, is that correct?

A. My pages are not numbered the same in this volume.

Q. It is the page headed "Summary of Inspection Data—All Transmission Lines Inspected".

A. If you will pardon me then.—

Q. (Interposing) Suppose you read the conclusions shown on that page.

A. Under the caption "Summary of Inspection Data—[fol. 9035] All Transmission Lines Inspected—

(1) Average over all per cent condition main pipe lines—97.7 per cent;

(2) Average over all per cent condition lateral pipe lines—99.7 per cent;

(3) Average over all depth of cover—42.9 inches.

Q. In arriving at these percentages, did you consider any factors other than those shown which you actually observed at the 37 inspection points? A. No.

Q. Did Mr. Riddle consider any factors other than those which he actually observed at the inspection points?

A. It would only be an assumption on my part to know what Mr. Riddle considered but I assume he certainly considered the inspection in the same manner that I did. I could not say what Mr. Riddle considered at all.

Q. To the best of your knowledge, you and Mr. Riddle used the same methods?

A. I would say yes to that.

Q. And as you have heretofore stated, you came out with precisely the same answer, is that right?

A. That is right.

Q. The title of your exhibit is, "Michigan Gas Transmission Corporation—Depreciation Study". Does Exhibit No. 81 purport to comprehend all elements of depreciation [fol. 9036] including functional as well as physical depreciation?

A. I would say any such depreciation study conducted of transmission pipe lines, buried or unburied, certainly cover all the elements that have to do with the lessening in value which is due to physical deterioration and action of the elements.

Q. You mean particularly with emphasis on the term that you just used "physical depreciation", is that correct?

A. That is right.

Q. I take it from your answer that your conclusions do not reflect any depreciation other than physical depreciation? A. That is right.

Q. Did you give consideration to each of the following causes of depreciation: First—wear and tear?

A. Yes.

Q. Second—decay?

A. Yes.

Q. Third—action of the elements?

A. Yes.

Q. Fourth—inadequacy?

A. Yes.

Q. Did you observe any inadequacy?

A. That is not observable but it was considered or weighted, I would say, in my mind in making a depreciation study but it certainly is not observable.

Q. Is the pipe line inadequate or is it not inadequate?

[fol. 9037] A. We did not make such a study.

Q. Then your conclusions do not reflect any such study of inadequacy?

A. Did I say they did?

Q. I am asking you.

A. If I did, I misunderstood the question.

Q. I think perhaps I misunderstood your answer.

A. I am not saying they reflected inadequacy, the per cent condition, absolutely not.

Q. I see. I am sorry but I think I misunderstood a previous answer that you gave.

Did you give consideration, in arriving at your conclusion, to the element of obsolescence?

A. In my answer to that, I would like to make more of a statement than yes or no.

Q. Very well.

A. I do not believe there is such a thing as obsolescence in pipe line systems so long as they serve to convey gas for the purpose for which they were originally constructed. Therefore, there would not be obsolescence in our pipe line systems.

Q. Certainly your condition per cents reflect nothing for the element of obsolescence?

A. Absolutely not.

Q. Absolutely not?

A. Absolutely not. My answer to that is no.

[fol. 9038] Q. Would the same be true of the factor of changes in the art? Did you make any study of that factor of depreciation?

A. No.

Q. What would you say with respect to the factor of changes in demand and requirements of public authorities?

A. In so far as such a depreciation study of pipe line systems, you cannot incorporate any per cent condition in your findings as to its physical condition due to demands of public authority, because they are certainly unknown by the observer.

Q. At least they were unknown by you as an observer?

A. That is right.

Q. And by Mr. Riddle?

A. That is right - now, I would not say for Mr. Riddle. I am speaking for myself only.

Q. In so far as you know, he used the same method?

A. That is right.

Q. What consideration, if any, did you give to the factor of exhaustion of natural gas resources?

A. None.

Q. Assuming the accuracy and the validity of a contention which is being made in these proceedings that the natural gas supply available to Michigan Gas Transmission Corporation will be exhausted 24 years hence, which of the elements of depreciation which I have named is most likely to bring about the retirement from service of the [fol. 9039] transmission mains of Michigan Gas Transmission Corporation?

A. I am not qualified to answer such a question.

Q. What is there about my question that causes you to say you are not qualified?

A. Any answer that I might give to that question, as put, would be an assumption on my part, purely an assumption.

Q. Haven't I given you enough assumptions, Mr. Lewis?

A. Absolutely based on assumption but I do not see that I could answer that question assuming the life of any property based on any findings of present day looking into the future. It would be valueless, any answer that I or any person might give, in my mind. We have not lived long enough to know the length of life of our properties.

Q. Mr. Lewis, you have answered hypothetical questions before, haven't you? I mean, don't be too much disturbed by some of these assumptions. I am going to ask you to assume, now, for purposes of this question, that the gas supply available to Michigan Gas Transmission Corporation will be exhausted 24 years hence. I want you to accept that as a fact for purposes of this question.

Now, assuming that to be a fact, which of the elements of depreciation which I have just enumerated is most likely to bring about the full depreciation and retirement from service of the transmission mains of Michigan Gas Transmission Corporation?

[fol. 9040] A. I would say this in answer to your hypothetical question: Physical deterioration should be the cause of the major portion of your retirements over the

years that we can look into the future. Personally, I have not lived long enough to even reach such a conclusion that I can pick out of thin air the life of our property.

Does that answer your question?

Q. I do not believe you have yet grappled with the question I have in mind. Let me put it this way.

Is there any doubt in your mind that these pipe lines of Michigan Gas Transmission Corporation will have a physical life extending beyond 24 years from the present?

A. Would you mind repeating that?

Mr. Littman: Suppose you read the question.

(Whereupon, the pending question was read by the reporter.)

The Witness: I believe no person can hope to make an estimate as to the life of the pipe line system of the Michigan Gas Transmission Corporation based on past experience and I also believe the life is many, many years more than 24 years, as you have expressed it. However, that is an assumption on my part in answer to your hypothetical question.

By Mr. Littman:

Q. But it is your best judgment, as I understand your testimony?

A. My best judgment would be that the life is far in excess of 24 years.

Q. From the present date?

A. I might add that age alone is no measure of depreciation.

Q. Well, we will come to that a little later.

A. Which I believe has a direct bearing on your question.

Q. It has no relation to your method of determining the physical depreciation of a property?

A. Absolutely not.

The character of study which you and Mr. Riddle made is the same as that which you would make on the mains of a water company, isn't that correct?

A. I am not qualified to answer that question, having never made an inspection of water mains.

Q. Did you ever make an inspection of manufactured gas mains?

A. Yes, sir.

Q. You made the same kind of inspection here as you would on manufactured gas mains, did you not?

A. To an extent, yes. In fact, manufactured gas mains are, as a rule, cast iron whereas we are dealing with steel pipelines in our Michigan Gas Transmission system.

Q. Assuming that Michigan Gas Transmission mains were being used for the purpose of transporting manufactured gas, you would have used the same method to determine the per cent condition as you used here?

A. That is right.

Q. Several of these inspection points are described by you to show pipe in 100 per cent condition. Will you tell us what you mean by the term "100 per cent condition"?

A. Well, a percentage condition is the condition found on the observed inspection, finding the pipe absolutely like new as compared to new alongside the pipe in the ground.

Q. Will you define the meaning of the term "zero per cent condition"?

A. Over a period of years—I do not know whether I can answer that question or not and having thousands of inspections—very few zero per cent conditions have I ever found.

Q. When did you find the last one?

A. I cannot remember that. It has been a long time ago, many years ago.

Q. Tell us what it means.

A. Well, in my mind, it would mean a pipe line which should be removed, absolutely could not be used further for the purpose for which it was intended. I would say it was hazardous to property and life in its location. It would be beyond any maintenance repairs that might be made on that particular piece of pipe in question.

Q. Assuming, Mr. Lewis, that this pipe line could not be used in place for the purpose of transporting gas, because [fol. 9043] there is no gas, and can no longer serve the purpose for which it was originally installed. What is the per cent condition of this line?

A. In so far as the pipe itself is concerned, it might be in 100 per cent condition. Just simply because you have

no gas to transport through a pipe line system does not change the percentage condition of the physical property.

Q. But if there is no gas for this line to transport, of what value is the line?

A. I made no such study in connection with our work on Michigan Gas. We simply made an observed depreciation study of the pipe line system as we found it in the ground.

Q. That is, of its physical condition? A. That is right.

Q. Zero per cent condition is related to that state of physical condition which is reached when the pipe can no longer serve its purpose physically, isn't that correct?

A. That is right.

Q. Now, Mr. Lewis, your condition per cents were not determined by any relationship to the service life of the pipe, were they? A. No.

Q. In other words, if you found 90 per cent condition, that does not mean that 10 per cent of the life of the pipe is gone?

[fol. 9044] A. You made a statement about "service life." I may have interpreted your question incorrectly. Your statement was service life, was it not, and my answer was no?

Q. Yes.

A. Maybe I do not understand your question, sir.

Q. Let's take a pipe that has a physical life of 50 years and assume that the pipe is 10 years old. You would not put that pipe in 20 per cent condition, would you?

A. I would not give consideration at all to the age of the pipe. Age would mean nothing to me.

Q. And the remaining physical life would also mean nothing?

A. It would mean nothing to me in establishing a per cent condition as found in an observed investigation as we now conduct it.

Q. Does your per cent condition in any manner reflect remaining life? A. No.

Q. In Exhibit No. 81, the various lines of Michigan Gas are designated A, B and C and also lateral lines. As I understand it, Line A, that is, the original Line A extends from the Indiana-Illinois State line eastward to Zionsville compressor station, is that correct?

A. That is correct.

Q. That is a 20-inch line, isn't it? A. That is right.
[fol. 9045] Q. And it was constructed in what year?

A. I have a record of the right-of-way date, 1930 and 1931 on Line A.

Q. Line A was constructed in the years 1930 and 1931, isn't that right? A. That is my understanding.

Q. And extends from the Indiana-Illinois State line to Zionsville compressor station, does it not?

A. That is right.

Q. That is a 20-inch line? A. Yes, sir.

Q. There is also a parallel line looping the old Line A which is a 24-inch line. Is that right? A. Yes, sir.

Q. Now, that is a new line. When was it installed, approximately?

A. I think about 1940, maybe some of it in 1941.

Q. You made no inspections on the new 24-inch loop line, did you? A. No.

Q. And neither did Mr. Riddle?

A. Not to my knowledge.

Q. What per cent of depreciation did you find on Line A, that is, the 20-inch line which was installed in 1930 and 1931? A. On Line A, 20-inch?

[fol. 9046] Q. Yes, I think you will find that on page 7 of Exhibit No. 81.

A. I found 100 per cent condition on the coated pipe, 92.2 per cent on the pipe not coated.

Mr. Littman: Will you please read back that answer?

(Whereupon, the last answer was read by the reporter.)

By Mr. Littman:

Q. What is the over-all per cent condition on Line A, 20-inch, both coated and uncoated?

A. I do not have that record here at all, the over-all per cent condition. The report was not set up that way. We have an over-all per cent condition on the main pipe lines which includes Line A.

Q. Can't you simply add the condition per cents shown on page 7 of Exhibit No. 81 and divide by the 8 inspection points?

A. Yes, I could, but I would prefer to do it off the stand, sir.

Q. You prefer to do it off what?

A. Any mathematics I would prefer to do off the stand, if permitted, if permitted to do it off the stand.

Q. Here is my arithmetic. A. (Interposing) Yes.

[fol. 9048] By Mr. Littman:

Q. Mr. Lewis, at the close of the morning session, I requested you to state what per cent condition you found for transmission Line A. Have you made the calculation?

A. I have. That amounts to 95.1 percent. That is the arithmetic average of coated and uncoated pipe on Line A.

Q. In other words, the 95 percent condition is the arithmetic average of the condition per cents shown on page 7 of Exhibit No. S1, is that correct?

A. My pages do not happen to be numbered the same as yours. I assume that it is.

Q. I hand you a copy of Exhibit No. S1 and ask you whether the figure you gave is the arithmetic average of the condition per cents shown on Page 7 of Exhibit No. S1? A. That is right.

Q. And I believe you have already testified that Line A was constructed in 1930 and 1931?

[fol. 9049] A. That is right, that is the right-of-way date.

Q. Inasmuch as Line A is 10 years old and inasmuch as you have found a percentage of depreciation on this line of 5 per cent, it is a fact that this depreciation on Line A has proceeded at an average rate of one-half of one per cent per year, has it not? A. Approximately.

Q. What over-all physical life of Line A is indicated by the average rate of one-half of one per cent depreciation per year?

A. The rate of depreciation, as observed at the time of our inspection, is not looking into the future life of Line A and the 95 per cent condition, as found at the time of the inspection, only represents the physical condition of the property on the observed date.

Q. Well, assuming that the depreciation which you found proceeds in the future at the same rate which you found that it proceeded in that past, the indicated physical life of that line would be 200 years, would it not?

A. Based on assumption only.

Q. Your answer to my question is "yes", based upon the assumptions that I have asked you to make?

A. I am not answering your question "yes". The life of any underground pipe line system cannot be based upon a per cent condition found as of today. It has been proven [fol. 9050] that pitting and corrosion do not accelerate or continue in a constant manner but rather pitting of our underground structures decelerates.

Q. Well, then I should conclude from your statement that the average over-all life of Line A would be not less than 200 years?

A. Much longer than 200, possibly, but no person has lived long enough to make even such a wild guess as to the length of life of an underground pipe line system.

Q. Well, Mr. Lewis, it is a fact that Line A is 10 years old, is that right? A. That is right.

Q. And you found only 5 per cent depreciation on that line, is that right?

A. That is right.

Q. The average rate of depreciation on that line over the 10 years is certainly one-half of one per cent per year, isn't that correct? A. That is right.

Q. Now, you say that in the future it could be expected that the depreciation would proceed at a decelerating rate?

A. That is right.

Q. Assuming that the depreciation proceeds in the future at the same rate as in the past, the indicated over-all life of Line A would be 200 [hundred] years, would it not?

[fol. 9051] A. That is right.

Q. And in view of your statement that it is expected that pitting proceeds at a decelerating rate through the years, it would be expected that the over-all physical life of Line A would be in excess of 200 years?

A. Much in excess, possibly.

Q. Let's examine the facts with respect to Line B. Line B extends from Montezuma compressor station eastward to Kings Station, does it not? A. No.

Q. Will you state the facts?

A. Line B extends eastward from Zionsville compressor station—

Q. (Interposing) I am sorry, I am always confusing Montezuma with Zionsville—from Zionsville eastward to Kings Station?

A. That is right.

Q. What is the size of that line? A. 18-inch.

Q. And it was constructed in 1931, was it not?

A. That is the right-of-way date, 1931, yes, sir.

Q. Now, what condition per cent did you find on Line B? A. 86.7 per cent.

Q. In other words, the depreciation was 13.3 per cent, was it not?

[fol. 9052] A. That is right.

Q. It is evident that the depreciation which you found had proceeded in the past at an average rate of 1.33 per cent per year, isn't that correct?

A. I assume your mathematics are correct.

Q. Well, we have 10 years and 13.3 per cent depreciation over the 10 years, which would be 1.33 per cent per year, wouldn't it? A. That is right.

Q. Now, assuming that the depreciation were to proceed in the future at the same rate as in the past, your finding of depreciation would indicate an over-all life for Line B of 75 years, would it not?

A. Assuming again that your mathematics are correct, I will agree.

Q. Now, let us look at Line C. That line extends from Zionsville compressor station northward to Melvindale which is the Detroit City gate, isn't that correct?

A. That is right.

Q. What is the size of that line, sir?

A. 22 inch.

Q. When was that line constructed? A. 1936.

Q. What percent condition did you find on Line C?

A. 99.3 per cent.

[fol. 9053] Q. In other words, 0.7 per cent depreciation?

A. That is right.

Q. In other words, the physical depreciation which you observed on Line C has proceeded at an average rate of 0.14 per cent per year, has it not?

A. Assuming your mathematics are correct, yes.

Q. And that rate of depreciation, if it were to proceed in the future as in the past indicates an over-all life of Line C of 714 years, does it not?

A. I assume it does, yes.

Q. I wonder whether you would kindly verify my arithmetic as I go along, please.

A. What are the years you are applying to that, on Line C?

Q. Line C, constructed in 1936, your depreciation is 0.7 per cent.

A. Are you considering the age 6 years, sir?

Q. I think I used 5 years? A. Five years?

Q. I think I used 5 years. I do not have my working papers with me but I am quite sure I did not count the year 1936 because that was the year in which the pipe was constructed. A. 14?

Q. The average rate is 0.14 per cent per year, is it not?

A. All right, 0.14.

[fol. 9054] Q. That is right? A. All right.

Q. I want now the indicated over-all life.

A. What was your figure, 250 years?

Q. Just a minute—

A. (Interposing) How did you obtain the 250 years?

Q. I had an indicated life of 714 years.

A. All right.

Q. Is that correct? A. All right, I will agree.

Q. Now, let us look at the lateral lines. Michigan Gas Transmission Corporation has a number of lateral lines, that extend off the main transmission lines?

A. Yes, that is right.

Q. Did you or anyone else make any inspections of any of the lateral lines?

A. No, sir, not to my knowledge. I made no inspection.

Q. And, so far as you know, Mr. Riddle made none?

A. That is right.

Q. I am quite sure he so testified in his direct examination, Mr. Lewis. What per cent condition did you assign to the lateral lines?

A. Well, the per cent condition was arrived at by applying the per cent condition as found on the main lines into which the lateral lines were connected or tied into. In [fol. 9055] other words, the arithmetic average, as found on the main line, was applied to the lateral.

Q. Can you be a little more specific for me with respect to the mechanics of that procedure? I will tell you what disturbs me and perhaps you can help me. Which particular inspection points did you select for a given lateral branching off from the main line? Did you select the inspection point and take the results obtained at the inspection point on the main line closest to the point where the lateral extends from the main line?

A. That or the arithmetic average of several that might have been on that same section of line. For example, if we had a section of line that was coated and inspections had been made on that coated section of main line and a lateral tie in occurred within that section, the per cent condition as found on the main line was applied to the lateral line.

Q. And, in some instances, you used merely a single inspection point?

A. If that occurred in the inspection of the property and I do not have in mind that it did occur, but it may have occurred. I rather think, if my memory serves me, that there was always more than one inspection involved in the application of a per cent condition on the lateral line. That also, I might add, would have been worked out exactly the same should the line have been not coated, the main line not coated and a lateral tie in occurred. The [fol. 9056] per cent condition on the main line would have been applied to the lateral tie in line.

Mr. Littman: Would you please read back that answer, it is rather lengthy but I would like to have it read back.

(Whereupon, the last answer was read by the reporter.)

By Mr. Littman:

Q. I am still not altogether clear with respect to the mechanics of your method. Perhaps you can take a specific lateral line and give us the inspection points which you used for that lateral line.

A. I do not have that information with me. I could not furnish you that information today.

Q. How far on either side of the lateral did you go?

A. That would depend entirely—for example, if you had 10 miles of coated pipe and within that 10 miles one lateral tie in occurred; then that entire 10 miles—if you

had made, say, two inspections on the main line—that entire 10 miles of pipe would have been considered. The two inspections would have been averaged and the average applied to the lateral tie in.

Q. Now, is that because the lateral lines are coated? Are they all coated?

A. Not necessarily. It has nothing to do with whether they are coated or uncoated. That has no bearing at all whether the lateral line is coated or not coated. Later, that was worked out and a weighted average per cent condition was based on the tonnage of pipe in the coated [fol. 9057] and uncoated sections of the lateral lines.

Q. Why do you speak of taking two inspections?

A. It may have been more than two. It may have been several. There may have been 50 miles of coated pipe. Should we only have one lateral tie-in, in the 50 miles, we may have had only five main line inspections so that the five main line inspections would have been tied in with the lateral line.

Q. Why did you confine your inspections to the coated laterals?

A. We did not. It occurred with uncoated laterals. I am only describing that as coated but the same thing would have occurred for uncoated. In 50 miles, five inspections were made on coated or uncoated. That per cent condition was applied to the lateral tie in within that section.

Q. Why weren't inspections made on these lateral lines?

A. Personally, I had nothing to do with the locating of the inspection points. My part in the field survey work was to make a depreciation study of the 37 inspection points that were spotted by the Central Service Corporation and, so far as the lateral lines are concerned, I just simply could not answer why they made no inspections on the lines. They just simply did not make any. However, they were laid in the later years and much the same soil condition existed as in the main line sections that were inspected and the percent condition applied to the lateral.

[fol. 9058] Q. They were installed in 1937, weren't they?

A. Yes, sir, my understanding is they were installed at a later time. I made no survey of those lateral lines so I have no information on the age.

Q. The map, Exhibit No. 78, shows, does it not, that the lateral lines were constructed in 1937?

A. Which lateral are you speaking of? Say, for example, this one into Tipton?

Q. I am speaking of them all, collectively.

A. I am not familiar with this—red shows 1936, doesn't it, or 1937? This is so near the color, what would you say, is it 1937? I rather think it is 1937. Is that right?

Q. That is what I thought.

A. All right, I believe it is 1937. I believe that is also orange. (Indicating.)

Q. Yes. A. Orange, indicating 1937 construction.

Q. Certainly they were constructed not later than 1937 because there are two shades of orange used on this map, one for 1937 and the other for 1936 and so I am correct in concluding, if this map is accurate, that the laterals shown thereon were not constructed later than 1937. Am I correct?

A. I would add with the exception—

Q. (Interposing) Your answer is "yes" with the exception?

[Vol. 9059] A. Yes, with the exception of this parallel line to Fort Wayne which was constructed in 1941, in part.

Q. Very well. Mr. Lewis, are you able to advise me with respect to the loop lateral extending from Line C to Fort Wayne which is colored in purple on Exhibit No. 78, which color is designated "1941 construction in progress", whether your depreciation studies comprehended and included that line?

A. Will you mind giving me the map a moment—Line C, 101, the original line was included—

Q. (Interposing) The original line that was constructed in 1937 was included?

A. That was included and my record before me indicates that the new line was not included.

Q. That comports with my understanding, namely, that the new line was a part of the construction work in progress as of June 30, 1941. A. That is right.

Q. Which was shown in one of Mr. Young's exhibits?

A. It had been completed to this point, it ended here and possibly continued on later (indicating).

Q. May we not conclude, Mr. Lewis, that the lateral lines which are covered in Exhibit No. 81 were those which were constructed not later than 1937? A. That is right.

Q. What percent condition did you assign to the lateral [fol. 9060] lines? A. The over-all per cent condition?

Q. Yes, I believe that is shown on page—

A. (Interposing) 99.7 per cent.

Q. 99.7 per cent?

A. 99.7 per cent was applied to all lateral lines.

Q. Now, that is 0.3 per cent depreciation, in other words, is that correct? A. That is right.

Q. Now, this 0.3 per cent of depreciation which you found, has accrued at the rate of 0.075 per cent per year on the average over the four years of life of these lateral lines, is that correct? A. That is correct.

Q. What over-all physical life of these lateral lines is indicated by the average rate of 0.075 per cent per year?

A. It has no bearing on the life of the line, the average rate, as you are applying it. The per cent condition is found by observed inspection. It does not indicate the future life of that property.

Q. Suppose you give me the indicated life which is comparable and similar to those which you have heretofore given me mathematically, based upon the assumption that the depreciation will proceed in the future at the same rate as it has proceeded in the past?

[fol. 9061] A. If I may furnish that calculation later, I would prefer to do it.

Q. It would only take a minute.

A. I would much prefer to do it off the stand, however.

Q. Well, the figure we get is 1333 years. A. Yes.

Q. Will you please check my calculation for me? Assuming the correctness of my arithmetic and assuming that the depreciation which you found proceeds in the future at the same rate as in the past, the indicated over-all age would be 1333 years, wouldn't it?

A. Assuming that your mathematics are correct.

Q. How many river crossings are there in the Michigan Gas Transmission system? I refer you to Exhibit No. 78, the map, to refresh your recollection.

A. Are you speaking of the navigable rivers or small streams, such as Raccoon Creek, White River and the Wabash?

Q. Let me read you a few that I took from the map and you can check me on them. A. All right.

Q. Line A—Wabash, Big Raccoon Creek.

A. All right.

Q. Sugar Creek. A. All right.

Q. Line B—White River crossing, do you know about that one? A. All right.

[fol. 9062] Q. Line C—Mississinewa. A. All right.

Q. Wabash River? A. All right.

Q. St. Mary's River, Maumee, Huron. A. All right.

Q. Tiffin and Raisin. A. All right.

Q. Now, did you make any inspections on any of those river crossings? A. No, sir.

Q. Nor did anyone else, did they?

A. Not to my knowledge.

Q. How many inspections did you make on the loop lines?

A. You are speaking of Line AA and BB, the 24-inch line, sir?

Q. Well, let's take the loop line extending parallel, approximately, with Line A and extending from the Indiana-Illinois line at Dana to Zionville.

A. It extends to Montezuma, does it not, the end of the line that you mentioned extends to Montezuma compressor station, Line A?

Q. Well, suppose you verify that on the map.

[fol. 9063] A. However, the answer is "no" on that line.

Q. Now, that line was installed partly in 1939 and partly in 1940, was it not, that is, the loop line?

A. I have no information as to the date of installation on the loop lines.

Q. I think the legend on the map, Exhibit No. 78, will show that. A. 1941, Line A.

Q. Did you say 1941? A. Yes, sir.

Q. You have just consulted the map. Will you please state the fact with respect to the loop line A?

A. No inspections were made on loop line A, 24-inch.

Q. And that line was constructed for the most part in the year 1940 and a short section thereof was constructed in 1939, is that right, according to the map, Exhibit No. 78?

A. Yes.

Q. That is the loop line?

The Witness: You will have to read me that question to answer it correctly.

(Whereupon the pending question was read by the reporter.)

The Witness: That is my understanding from the map.

By Mr. Littman:

Q. Did you or Mr. Riddle make any separate determination of the per cent condition of the coating on the coated pipe? A. On the coating or coated pipe?

[fol. 9064] Q. Of the coating on the coated pipe.

A. If you will pardon me, if I may state the question—did we make an inspection of the coating?

Q. Did you make a separate determination of the condition per cent of the coating? A. No.

Q. Will you please turn to page 7 of Exhibit No. 81?

A. What line is it, sir?

Q. Line A. A. All right.

Q. I note from inspection Nos. 1, 2 and 3 shown on the table on that page, that those inspections were made on coated pipe. Is that correct? A. That is right.

Q. Now, you found the pipe at those points in 100 per cent condition, is that correct? A. That is correct.

Q. This line was laid in 1930 and 1931, is that right?

A. Those are the right-of-way dates, 1930, 1931.

Q. Is it your testimony that the coating on this pipe, which is 10 years old is as good as it was when it was first installed?

A. I am not testifying as to the coating condition at all. I am testifying as to pipe condition, the material protected [fol. 9065] by the protective pipe coating.

Q. Now, you found that pipe in 100 per cent condition notwithstanding the fact that it had been in the ground for 10 years, is that right?

The Witness: Would you read that question, please?

(Whereupon the pending question was read by the reporter.)

The Witness: That is right.

By Mr. Littman:

Q. And notwithstanding the fact that that pipe had already marched for 10 years along the road to the scrap heap, isn't that right?

A. Would you mind stating that question again? I do not seem to get your question clearly.

Trial Examiner: I believe he is quoting.

Mr. Littman: My apologies to Mr. Chief Justice Stone.

By Mr. Littman:

Q. I will rephrase my question. You found the pipe at this inspection point in 100 per cent condition notwithstanding the fact that it had marched along for 10 years toward the scrap heap. It is 10 years closer to the scrap heap today than it was when it was first installed, isn't it?

A. I would not say that it is.

Q. You would not say that it is?

A. No, sir, absolutely not. Ten years does not make a bit of difference. The time element has nothing to do with it. It is the physical condition we found at the time [fol. 9066] of the inspection. The pipe had been well protected by this protective coating at the points we inspected. The pipe was as good as new at the three points that are in question.

Q. But it is still 10 years closer to the date of its eventual retirement than it was when it was first installed, isn't it, even though it looks just as good as new?

A. Again age alone is no measure of depreciation.

Mr. Littman: Let me have that answer, will you please?

(Whereupon the last answer was read by the reporter.)

By Mr. Littman:

Q. Well, it is a measure of how much service it is going to give as related to time, isn't it?

A. No measure at all of the future service of that pipe line.

Q. You will certainly concede, won't you, that that piece of pipe is 10 years closer to the date when the gas supply will be exhausted?

A. That may be true. However, the percentages applied to the three inspection points in question have no bearing on the future life of our gas supply.

Q. In other words, what you are saying is that you did not take that element into account? A. Absolutely not.

Q. In making your determination?
[fol. 9067] A. Absolutely not.

Q. Have you ever made a depreciation study wherein you have taken that element into account? A. No, sir.

Q. I want you to describe how you translate your data shown in Exhibit No. 81 to per cent condition?

A. I just do not understand your question, sir. What do you want translated?

Q. I want to know how you arrive at your percent condition at these various inspection points.

A. I understand you now.

Q. I want you to describe your method.

A. How we arrived at the per cent condition at each inspection point?

Q. Generally, yes.

A. Well, the pipe was carefully scrutinized for all indications of corrosion or pitting. The entire surface was so examined, the bottom half as well as the top half, sides, top shoulders and bottom shoulders. If any pitting was found at all in the cleaned section of the pipe that was measurable, these pits were measured and so reported on our field inspection form. An Ames dial gage was used for the purpose of measuring the pit depths. From the information gained at each inspection point, a per cent condition was applied which is purely a judgment figure, comparing in my mind the condition of the pipe under [fol. 9068] observation with new pipe alongside of that pipe.

Q. That is a judgment of what?

A. Judgment of the physical condition as compared to new pipe.

Q. Not a judgment of how much longer the pipe is going to serve? A. No, absolutely not.

Q. Not a judgment of how much service has departed?

A. Absolutely no comparison.

Q. And it has no relation to time, according to your theory? A. Yes, I would say time enters the picture.

Q. Well, you cannot give us any further enlightenment as to the mental gyrations through which you went to reach the ultimate per cent condition from the data which you have described?

A. I would say, rather than the term "mental gyrations", they more truly could be termed "years of experience" working with pipes of similar materials, installing such pipes, actually making the installations yourself, supervising such installations in varying sizes of pipe over a period of time, being familiar with new pipe as well as pipe that has been in use for quite some time, basing my per cent condition entirely upon my judgment as to its condition as compared to new pipe.

[fol. 9069] Q. What does 95 per cent condition mean, 95 per cent of what?

A. As compared to a new piece of pipe alongside of it.

Q. You say 5 per cent is gone. Is that what you say when you find pipe in 95 per cent condition?

A. I would say it has depreciated 5 per cent.

Q. Was the depth of the maximum pit the controlling factor in your determination of per cent condition?

A. Not entirely, not entirely, not in every case. It only had part to do with the per cent condition which we have reported in our 37 inspections.

Q. How much weight did you give to the deepest pit?

A. There is no way in the world that I could explain to you or any other person the weight given to pitting other than it is my judgment, following my examination of the surface of the pipe presented for inspection of any corrosion or pitting that occurred as compared to new pipe.

Q. Where you found no pitting, you assigned a per cent condition of 100, is that right? A. Yes, that is right.

Q. Notwithstanding anything else that may have been found at the inspection point, isn't that right?

A. There was nothing else found. It was perfect pipe, the same as the day it came out of the mill.

Q. What significance do you attach to pitting which is [fol. 9070] described as "etched" or "small"? I note

those two descriptions appear opposite each other on these inspection reports.

A. In so far as they are appearing opposite, it has no significance, their appearing opposite. However, do you want a description of what I mean by "etched"?

Q. No, I want you to tell me what difference does it make if a pit is etched or if it is small?

A. In what way does it make a difference, do you mean, in per cent condition?

Q. Yes, in what way would it make a difference to you, assuming that the two pits are of equal depth?

A. Well, I believe I will have to describe the etching condition, as I see it, and small pits, as I may see it, in my observed inspection in order to make it clear.

Q. All right.

A. An etched surface found upon examination would be one we will describe as the most minute series of pittings possible to imagine, if you are familiar with pipe materials, possibly occupying a very small area on the entire surface of the pipe examined and closely related one to another in their location on the pipe, in more of a close knitted area, if I might say that. Small pitting would be described as very minute in diameter, very small, rather, in diameter and depth possibly. The term "small" is used in this inspection report as not having anything to do with the [fol. 9071] number of pits but with the size of the pits as found.

[fol. 9072] By Mr. Littman:

Q. Assuming that you have two pits at an inspection point of equal depth, one of which is etched and the other of which is small, within the meaning of your definition. What difference would that make?

A. In per cent condition?

Q. Yes. A. Possibly none.

Q. I will ask you the same question with respect to the two pits of equal depth, one of which is "large" and the other of which is "sharp". What difference, if any, would that make?

A. A larger pit being one that covered considerable area, affecting considerable area of the metal and sharp

being descriptive of the type of pitting we will find on steel pipe; the penetration being much sharper on steel pipe than on wrought iron pipe.

[fol. 9073] Q. What difference would it make in per cent condition?

A. I would have to see the particular pipe to answer your question, sir.

Q. Well, so far as I am concerned, you can write your own ticket, using your own definition of a large pit and a sharp pit; both of the same depth, what difference would that make in your per cent condition, whether one is large and the other is sharp?

A. I would still have to see the pipe in order to put a per cent condition on it.

Q. Suppose you had two pits, one of which was "blotchy" and the other of which is one of a number of "scattered" pits and both pits are of the same depth. What difference would that make in your per cent condition?

A. It might make none. I would have to see the pipe before I could put a per cent condition on it.

Q. What weight, if any, did you give to the character of the soil in arriving at your per cent condition?

A. At the time of the inspection, we made a record of the kind of soil covering our pipe line system.

Q. What weight, if any, did you accord to that fact?

A. None.

Q. Did you consider any factors in arriving at your per cent condition other than those which you recorded in your [fol. 9074] inspection sheets shown in Exhibit No. 81?

A. I think we have all the facts before us in the individual inspection sheets that were considered in arriving at the per cent condition.

Q. In other words, everything that you took into account in arriving at your per cent condition or condition per cents, and all the data which you used in arriving at your condition per cents are shown in these inspection sheets in Exhibit No. 81, is that correct? A. That is right.

Q. In other words, if you had before you the data at the particular inspection point as shown in one of these sheets, you could determine a per cent condition therefrom?

A. If I have the pipe.

Q. What? A. If I had the pipe along with it.

Q. You would have to have the pipe along with it?

A. Certainly.

Q. I thought you said you did not consider anything other than the data which is shown on these inspection sheets.

A. I considered the data here—I obtained the data in the field from the pipe that I have recorded here, not from the sheet to the pipe. We recorded our findings in the field after observation of the pipe condition.

Q. Assume that at an inspection point, the wall thickness [fol. 9075] of the pipe, which is steel pipe, is 0.281 inches and the maximum pit depth is 0.05 inches and the average estimated pit depth is 0.01 inches; the pitting is etched, sharp, scattered and few; the soil is clay, loam and gravel and the pipe was painted in the mill. What is the per cent condition of that pipe? A. I would have to see the pipe.

Q. In other words, there are some data that you took into account that are not recorded on these inspection sheets?

A. The data that we have recorded on the inspection sheets was obtained in the field by observation and so recorded.

Q. That other factors that are not shown on these inspection sheets would change the per cent condition?

A. I know of no other factors that will change the per cent condition as shown on our inspection sheets. The facts are shown on the inspection sheets as recorded in the field at the time of observation.

Q. Why do you have to look at the pipe if you have all of the data here that you recorded which you felt was necessary to take into account to arrive at a per cent condition?

A. Those are the facts that we obtained in the field from observed conditions of the pipe at the time of inspection.

Q. What is there that you would have to see about the pipe?

A. The entire surface of the exposed section under test [fol. 9076] or inspection.

Q. You have all of that described on your inspection sheets, have you not?

A. That is right and we obtained it from the pipe that is in the ground that we observed. That is nothing more than a record of our findings, an exact record of our findings in the field.

Q. Well, your inspection sheet shows the character of pipe, the wall thickness and the depth of pit, does it not?

A. Yes.

Q. So far as that is concerned, you would not have to go out in the field to see that, would you?

A. How are you going to obtain depth of pitting, for example?

Q. I mean if I gave you the depth of pits, that is all you would need?

A. There is more to it than the depth of the pit, than just the physical measurement of one pit or several pits. It is the general condition observed over the entire surface of the pipe, the number of pits, the general corrosion.

Q. You have described all those matters here in your inspection sheets, haven't you? A. That is right.

Q. Why do you have to go out and look at it the second time if I give you your own description?

[fol. 9077.] A. That certainly would be impossible, to make it even come close.

Mr. Wheat: Mr. Littman, Mr. Baldrige suggests that possibly a good analogy would be that of a man trying to judge a beauty contest from a series of typewritten measurements.

Mr. Littman: Yes, but the analogy is not at all proper.

By Mr. Littman:

Q. You have your own description here, have you not, of everything you saw?

A. That is right, obtained in the field from observing the pipe.

Q. And you say that is all you considered?

A. Absolutely recorded all we found in the field.

Q. What is there that you saw?

A. Exactly what you have recorded in front of you on each inspection.

Q. Well, if I read you those data, why do you have to go out and look at it again?

A. In other words, you can make a hypothetical case here and hand it to me and expect me to put a per cent condition on it or even take one out of our record and put a per cent condition on it—that is impossible.

Q. That is impossible?

A. Absolutely. We have got to see the pipe.

Q. I take it then there is some data that you considered [fol. 9078] that is not fully described in these inspection sheets?

A. Other than my judgment and that is the judgment figure in the per cent condition that you have.

Q. I take it from your testimony that the description of the data observed at the various inspection points as shown in the pipe inspection reports in Exhibit 81 are not sufficient upon which to base a per cent condition without actually going out and observing the pipe?

A. That is right.

Q. Now, the inspection point which I described is the one shown on page 14 of Exhibit No. 81, to wit, inspection report No. 8. Now, you found the pipe at that inspection point in 95 per cent condition, did you not?

A. That is right.

Q. Will you turn to the inspection report No. 12 which is shown on page 19 of Exhibit No. 81. There you will observe the identical description as that which appears for inspection point No. 8, isn't that correct?

A. Were we comparing No. 6, inspection No. 6 and 12?

Q. We were comparing inspection No. 8 with inspection [fol. 9079] No. 12. Now, let's compare the two. At both these points, the pipe is painted. Is that right?

A. That is right.

Q. The maximum pit depth is 0.05 inches and the average pit depth is 0.01 inches. Is that right?

A. That is right.

Q. The pitting in both cases is described as "small, sharp, scattered and few", is that correct?

A. That is right.

Q. The wall thickness of the pipe in both cases is 0.281 inches, is that right? A. That is right.

Q. The soil is practically the same, but we need not discuss that because you did not take the soil into account in arriving at your per cent condition, did you?

A. No, I did not.

Q. Now, in the case of inspection point No. 8, you found that in 95 per cent condition, didn't you? A. That is right.

Q. Now, as to inspection point No. 12, you found that in 85 per cent condition, did you not? A. That is right.

Q. Why did you find the one in 85 per cent condition and the other in 95 per cent condition?

[fol. 9080] A. Again I would have to see the pipe.

Q. Can you tell me what you would see that would cause a variation of 10 points between the two inspections?

A. I cannot tell you from my memory what we would see in reference to these two inspections we are discussing, No. 8 and No. 12. My memory does not serve me that well to tell you what we found on one inspection as against what we found on the other inspection.

Q. Well, you have got the same data recorded for both, haven't you? A. That is true.

Q. What, in your opinion, could cause such a difference?

A. Now, we can get an answer maybe. It would be very easy to answer that. Possibly the pitting was more numerous on one inspection than on the other—

Q. (Interposing) Just a minute, right there. You describe the pitting exactly the same. You say "scattered and few". A. That is true.

Q. Don't those descriptions cover the same general character of pitting?

A. That is true but still you could have more numerous pitting on one than on another. We are not comparing one inspection point with another inspection point when we apply a per cent condition. We are comparing our observed condition with new pipe.

[fol. 9081] Q. You cannot tell us at this time what caused the variation?

A. Absolutely not. I would have to see the pipe.

Q. Let's look at inspection No. 5 which appears on page 12 of Exhibit No. 81. You found the pipe at that point in 85 per cent condition, did you not?

A. That is right.

Q. The maximum pit is 0.17 inches, is it not?

A. That is right.

Q. Now, that pit is slightly—that is the maximum pit, isn't it, 0.17? A. Yes, the maximum pit is 0.17.

Q. Now, that maximum pit is slightly more than 50 per cent through the pipe wall, is it not?

A. That is correct.

Q. Now, let's look at inspection point No. 9. What is the maximum pit depth at that point? A. No. 9, sir?

Q. Yes, which is shown on page 17 of Exhibit No. 81.

A. 0.06 is the maximum pit.

Q. Now, that pit is approximately 18 per cent through the pipe wall, isn't it? A. That is right.

Q. And your per cent condition at that point is 85 per [fol. 9082] cent, is it not? A. That is correct.

Q. In other words, in one place you have a maximum pit that is slightly more than 50 per cent through the pipe wall. A. That is right.

Q. And in another place at another inspection point, you have the maximum pit which is 18 per cent through the pipe wall and yet you place both of them in 85 per cent condition. Is that correct? A. That is correct.

Q. Now, looking at inspection point No. 8 which appears on page 14—

A. (Interposing) Inspection point No. 8?

Q. Inspection point No. 8, at that inspection point your maximum pit is 0.08 inches—

A. (Interposing) I beg your pardon, sir. My inspection point No. 8 shows 0.05.

Q. I am sorry, that is right, 0.05 inches. The maximum pit at inspection point No. 8 is 18 per cent through the pipe wall, isn't it, approximately? A. Approximately.

Q. Yet you find that inspection point in 95 per cent condition, do you not? A. That is correct.

[fol. 9085] (Exhibit No. 81 was received in evidence.)

(Exhibit No. 87 was received in evidence.)

[fol. 9086] (Exhibit No. 92 was received in evidence.)

[fol. 9087] (Exhibit No. 94 was received in evidence.)

(Exhibit No. 98 was received in evidence.)

(Exhibit No. 100 was received in evidence.)

Mr. Littman: I would like to take up next Exhibit No. 104 entitled, "Michigan Gas Transmission Corporation—Estimates" which is the pro forma statement offered by Mr. Spitznagle and also Mr. Green. I believe that this exhibit contains a number of objectionable figures and references. However, I shall not object to the admission of this exhibit simply because if any of the figures herein were to be stricken the entire exhibit would be meaningless.

[fol. 9088] The exhibit contains numerous calculations and derivatives comprehending the entire case of Michigan Gas Transmission Corporation. It serves to tie together and present in one summary statement all of the contentions of Michigan Gas. I merely want it understood that my failure to object at this point to certain of the figures for which the underlying exhibits have been already ruled upon as not admissible should not be taken to be any waiver by Commission counsel of its right to contend that reproduction cost evidence should be excluded from consideration.

I think perhaps I have made myself clear upon the record with respect to our position. I simply dislike striking any part of this exhibit because I fear that the entire exhibit would be meaningless if we were to have stricken certain objectionable features thereof.

Trial Examiner: It has been made clear in your statement and previously in the record that any evidence which might be directed to support the evidence of reproduction cost now will be disregarded in the analysis of this proceeding.

The proposed exhibit marked for identification as Exhibit No. 104 comprising six sheets will be received.

(Exhibit No. 104 was received in evidence.)

[fol. 9089] (Exhibit No. 105 was received in evidence.)

[fol. 9099] Mr. Baldridge: May I at this time, Mr. Examiner, go back and re-offer those parts of Exhibits 83, 84, and 86 and all of Exhibit 97 which have heretofore been excluded and, without entering into any extended discussion, I would like to point out that the recent opinion of the Supreme Court of the United States in the Natural Gas Pipeline Company case does not hold that evidence of this kind, whether you call it evidence of reproduction cost or whether you call it trends and indices, is improper evidence for reception by the Commission.

Mr. Littman: Are we going to use as precedent matters which the Supreme Court did not decide? I understood Mr. Baldridge to state they did not decide certain things and he was pressing that as an argument for the inclusion in evidence here of reproduction cost. Indeed, as the three Justices who wrote the concurring opinion stated, namely, Justices Douglas, Murphy, and Black, in their judgment the majority opinion holds that the Commission no longer need admit evidence of reproduction cost.

Mr. Wheat: Where does it say that?

Mr. Littman: The quotation upon which I am relying as authority for my statement is as follows, and I now read from the concurring opinion written by Mr. Justice Black:

"As we read the opinion of the Court, the Commission is [fol. 9100] now freed from the compulsion of admitting evidence on reproduction cost or of giving any weight to that element of 'fair value'. The Commission may now adopt, if it chooses, prudent investment as a rate base—the base long advocated by Mr. Justice Brandeis. And for the reasons stated by Mr. Justice Brandeis in the Southwestern Bell Telephone case there could be no constitutional objection if the Commission adhered to that formula and rejected all others."

Now, who am I or who is Mr. Baldridge to read or interpret the majority opinion any differently than that opinion was interpreted by three Justices who wrote the concurring opinion? Certainly I shan't undertake to disagree with

the three concurring Justices as to the proper interpretation to be placed upon the majority opinion. Certainly the opinion is authority for the proposition that this Commission need not accept any evidence of reproduction cost.

Trial Examiner: The Trial Examiner has referred to the record in regard to the exclusions of Exhibits 83, 84, and 86, which were excluded at page 8230 and page 8231 of the transcript and then exhibits as reformed responsive to Commission counsel's motion were afterward received with corresponding numbers. It would seem to the Trial Examiner that there is less question at this time than there was when the ruling was originally made so the renewed offer is again rejected and the original exhibits as offered, [fol. 9101] are again excluded with an exception if you wish it.

[fol. 9136] LEITH V. WATKINS, a witness previously called and duly sworn, resumed the stand and was examined and testified further as follows:

Direct Examination (Continued)

By Mr. Wheat:

Q. Mr. Watkins, will you please turn to the next document which you have prepared in connection with this matter and which I believe has been distributed, state what it is and what it shows. I believe it is the one giving effect to certain financing transactions consummated on February 6, 1942.

A. That is correct. The next document which the witness has had prepared for presentation in these proceedings is that consisting of pro forma consolidated balance sheet as of December 31, 1941, which gives effect to financial transactions consummated on February 6, 1942, by Panhandle Eastern Pipe Line Company and the acquisition on that date of the capital stock and debt of Michigan Gas Transmission Corporation and the Indiana Gas Distribution Corporation and the purchase of certain transmission properties of Ohio Fuel Gas Company by Panhandle Eastern Pipe Line Company. This document consists of five pages.

[Vol. 9137] Pages Nos. 4 and 2 consist of a pro forma balance sheet as of December 31, 1941, while pages Nos. 3, 4, and 5 carry certain notes to such balance sheet and adjusting journal entries thereto.

Q. Mr. Watkins, are those transactions the ones which were discussed by the Securities and Exchange Commission in the document which has been received in this proceeding as Exhibit No. 147?

A. I believe they are, sir. Is that exhibit an order of the Securities and Exchange Commission?

Q. It is, yes.

Mr. Wheat: Mr. Examiner, may the document just mentioned by the witness, consisting of five pages, be marked for identification as Exhibit No. 194?

(The document referred to was marked Exhibit No. 194 for identification.)

By Mr. Wheat:

Q. Mr. Watkins, will you state how Exhibit No. 194 for identification was developed and what you have shown thereon?

A. In the development of Exhibit No. 194 for identification, we first combined the assets and liabilities of Panhandle Eastern Pipe Line Company and its newly acquired wholly owned subsidiaries, Michigan Gas Transmission Corporation and Indiana Gas Distribution Corporation, [Vol. 9138] as of December 31, 1941.

Q. Panhandle Eastern did acquire certain properties from the Ohio Fuel Gas Company, did it not?

A. Those properties are likewise included in the balance sheet under the column on both pages 1 and 2 which carries as its heading the word "Combined."

Q. When you say that you did this as of December 31, with respect to financial transactions consummated on February 6 of the next year, how did you accomplish that?

A. We took the balance sheets of the three companies and the properties acquired from Ohio Fuel Gas Company as though they had been acquired on December 31, 1941, and developed the figures shown in the column which the witness has just referred to, carrying as its heading the word "Combined."

Q. Then what did you do to get the final column headed "Consolidated"?

A. It was then necessary to make certain adjustments which are shown on pages 4 and 5 of this Exhibit No. 194 for identification.

As an illustration, the first adjustment required was that on page 4, through which we adjusted cash by \$25,156, \$42.93 to record the sale of \$15,000,000 principal amount of 5.60 percent cumulative preferred stock and \$10,000,000 principal amount of first mortgage and first lien 3 percent [fol. 9139] bonds, series "C", of Panhandle Eastern Pipe Line Company, and the credits shown in adjusting entry No. 1, established for the purpose of this pro forma balance sheet as of December 31, 1941, give effect to such issue and sale of securities.

Q. And that item is shown with the figure one in parentheses, is it not, on page 1, opposite the item "Cash" and under the column headed "Adjustments and Eliminations Debit"?

A. As to that page, yes, sir, and it is likewise shown on page 2 followed by the numeral one in parentheses in the column headed "Credit" under the general heading "Adjustments and Eliminations" on that page.

Q. In other words, page 1 shows the asset portions of the balance sheet and page 2 the liability portions, is that true? A. That is true.

Q. Now, will you proceed with your explanation of what you did?

A. It was then necessary to record an adjusting entry to give effect to the purchase of stock and debt of Michigan Gas Transmission Corporation and Indiana Gas Distribution Corporation and certain transmission facilities from the Ohio Fuel Gas Company. To this entry, gas plant in service is charged with \$439,326.08, the cost of securities acquired of associated companies amounting to \$8,331, [fol. 9140] 715.02 is taken into the records, the amount of the advances to associated companies being \$2,435,000 is established and a small amount of expense incident to the acquisition of the new securities amounting to \$896.40 is charged to other work in progress. To accomplish this acquisition, cash is credited with \$11,206,937.50. These amounts are shown in appropriate places in the adjust-

ments and elimination columns on pages 1 and 2 of Exhibit for identification No. 194.

In the general description of this proposed exhibit, mention was made of the notes on page 3. They are simply notes explanatory to the pro forma balance sheet and are not in the form of an adjustment.

Is that sufficient, sir?

Q. That, I think is, yes.

[fol. 9141] Will you proceed to your next adjustment?

A. Out of the cash arising from the sale of the securities represented by adjusting journal entry No. 1 shown on page 4 of this proposed exhibit, \$10,000,000 was used for the redemption of the company's Class A preferred stock and the payment of dividends thereon to date of redemption. The effect of this use is represented by adjusting journal entry No. 3 on page 4 of the proposed exhibit and the entries appropriate to give effect to this entry in the balance sheet are shown in the appropriate columns under the general heading "Adjustments and Eliminations" on pages 1 and 2 of Exhibit No. 194 for identification.

Q. I think that sufficiently covers item No. 3. Will you now explain item No. 4 of the adjusting journal entries?

A. May I in such explanation combine entries 4, 5, and 6?

Q. Yes, I think that would help.

A. In order to properly portray a consolidated balance sheet it is necessary, of course, to eliminate intercompany items. Adjusting journal entries Nos. 4, 5, and 6 constitute the eliminations necessary in this instance, and it is believed the explanations to such entries clearly state the purpose therefor.

Q. Let me ask you if it is your opinion that Exhibit No. 194 for identification correctly shows what it purports [fol. 9142] to show as explained by you. A: It does.

(Exhibit No. 194 was received in evidence.)

Mr. Littman: Mr. Watkins, before you leave Exhibit No. 194, I would like to know whether you meant to say

that you had included the item of "Gas Plant in Service" in the amount \$439,326.08 shown as item 2 on page 4 in the combined amount of gas plant shown on page 1 in the sum of \$82,652,330.74.

The Witness: If I did, sir, I thank you very much for correcting me because it surely should not be in there.

By Mr. Wheat:

Q. Will you state why, so the record will be clear?

A. Because, Mr. Wheat, the addition of this amount to gas plant did not take effect until the adjusting entries were made and, of course, the amount was not a part and parcel of any of the balance sheets included in the column on pages 1 and 2 of this proposed exhibit headed by the word "Combined."

[fol. 9143] Q. The effect of this, as well as all of the other items covered by the adjustments and eliminations, occurs and is shown in the columns on pages 1 and 2 headed "Consolidated", is that correct?

A. The general effect is there shown, yes, sir.

Q. Mr. Watkins, will you then pass to the next document prepared by you in connection with this proceeding and state what it is and what it shows?

A. The next document is a pro forma consolidated income account for the year ended December 31, 1941, and, as shown by note No. 1 on page 3 of the proposed exhibit, is a condensed pro forma consolidated income account of the company and its subsidiaries, Michigan Gas Transmission Corporation and Indiana Gas Distribution Corporation, which has been prepared from the books of the companies on the basis that the financing of the cost of the acquisition of the outstanding stock and indebtedness of Michigan Gas Transmission Corporation and Indiana Gas Distribution Corporation resulted in an annual interest cost of \$300,000, and which was consummated on February 6, 1942, had been effected January 1, 1941, and that the interest expense shown as applicable to the obligations of Michigan Gas Transmission Corporation and Indiana Gas Distribution Corporation to Columbia Gas & Electric Corporation, then their parent, would have aggregated the same amount had Panhandle Eastern Pipe

Line Company been the parent company and that the dividends had been paid by Michigan Gas Transmission Corporation and Indiana Gas Distribution Corporation to the extent of their net income for the year and is after giving effect to the estimated increases in Federal income taxes which would have resulted, had such interest and dividends been paid by Michigan Gas Transmission Corporation and Indiana Gas Distribution Corporation to Panhandle Eastern Pipe Line Company to the full extent of the net income of those companies.

Q. Mr. Watkins, did you not mispeak yourself at the outset of your last answer when you spoke only of Panhandle Eastern and its subsidiaries, Michigan Gas Transmission Corporation and Indiana Gas Distribution Corporation? Did you not mean Panhandle Eastern Company and its subsidiaries, to wit, Illinois Natural Gas Company and Michigan Gas Transmission Corporation and Indiana Gas Distribution Corporation? A. That is correct, sir.

[fol. 9145] (The document referred to was marked Exhibit No. 195 for identification.)

Q. Now, in the figures which are shown in pages 1 and 2 of Exhibit No. 195 for identification, have all of the items which you mentioned in your last somewhat lengthy answer been given their full consideration by you?

A. They have and the data shown in the column headed by the word "consolidated" shows the effect of the conditions explained in the answer which you characterized as a lengthy one as though that condition has existed throughout the entire year 1941.

Q. Now, are there any items which you believe ought to be explained in order that thorough understanding may be had of this exhibit?

A. Unless there be some misunderstanding on the part of someone with respect to the method of treatment of additional provision for Federal income taxes arising from the consideration in this pro forma consolidated income account of the receipt by Panhandle Eastern Pipe Line Company of the interest of the obligations of Michigan Gas Transmission Corporation and Indiana Gas Distribution Corporation and from the receipt by Pan-

[fol. 9146]

handle Eastern of the remainder of the net income of those companies as dividends, the data should be self-explanatory.

When the witness refers to the word "receipt", it is in the light of the treatment with respect to this particular proposed exhibit. We know, of course, that there was no such constructive receipt for the year 1941.

Q. What is the elimination which is headed "No. 4" on page 2 and how does that come about?

A. In order to properly consolidate the operations of Panhandle Eastern and its subsidiary company, any inter-company transactions must be eliminated. The only inter-company transaction necessary in connection with this proposed exhibit is that represented by the sale of gas by Panhandle Eastern Pipe Line Company to the subsidiary companies. All eliminations between Panhandle Eastern and its subsidiary, Illinois Natural Gas Company, had been made prior to the development of the figures shown on Page 1 of this exhibit in the column headed by the word "Combined."

[fol. 9147] Mr. Littman: I have a few questions I would like to ask about Exhibit No. 195.

As I understand Exhibit No. 195 and also Exhibit No. 194, you have included certain figures reflecting a company called "Indiana Gas Distribution Corporation", is that correct?

The Witness: That is correct.

Mr. Littman: That corporation is not a natural gas company, is it, within the meaning of the Natural Gas Act?

The Witness: It is not.

Mr. Littman: In other words, it engages, strictly speaking, in the distribution of natural gas within certain city limits, isn't that correct?

The Witness: I do not know whether they could be characterized, really, as cities. They may be, under the laws of the State of Indiana. They are somewhat small if they are cities but, generally, your statement is correct. It has a few lateral lines. These lateral lines, probably

have a recorded cost of not more than \$50,000. Whether they are in a position similar to the lateral lines of Illinois Natural Gas Company in the light of the law, I do not know.

Mr. Littman: But the balance of its property, other than the lateral lines is purely distribution?

The Witness: That is correct.

Mr. Littman: Can you give us an idea of the size or amount of the property and income involved?

[fol. 9148] The Witness: My remembrance is that the total investment is possibly less than \$200,000.

Mr. Littman: I think some of those figures are shown in Exhibit No. 145 but I would like to get an idea of approximately the magnitude and size of this Indiana Gas Distribution Corporation and to what extent it affects the picture?

The Witness: Would you like me to refer, in my response, to Exhibit No. 145?

Mr. Littman: Yes, I think it might be well to have it stated at this point.

The Witness: Page No. T 14 of Exhibit 145—we may now refer to that as an exhibit, may we not?

Mr. Littman: Yes.

The Witness: (Consulting) Contains a balance sheet of Indiana Gas Distribution Corporation as of December 31, 1940, and as of September 30, 1941. It is my personal belief that the balance sheet as of September 30, 1941, is probably fairly representative of the company's assets and liabilities at the moment.

That balance sheet shows its property, plant and equipment as having a recorded cost of \$195,000; its total assets \$240,000; its demand obligations consisting of notes and open accounts \$141,000; with outstanding capital stock of \$1,000 and surplus at that time of some \$11,698.20.

Is that sufficient, sir, for the balance sheet?

[fol. 9149] Mr. Littman: Yes, for the balance sheet, for the present.

Now, will you give us some idea of the size of the company with respect to the income statement?

The Witness: On page T-15 of Exhibit No. 145 is shown an income statement of Indiana Gas Distribution Corporation for the years ended December 31, 1938, 1939, 1940 and the nine months ended September 30, 1941, the year 1940 being the last full year of operation, may we refer to that rather than the nine months ended September 30, 1941?

Mr. Littman: I think it would be preferable because it gives us a full year.

The Witness: In that year the total gas revenue of Indiana Gas Distribution Corporation was \$403,957.10; its total operation expenses amounted to \$373,668.02 of which \$335,747.54 represented cost of gas purchased from Michigan Gas Transmission Corporation. Its net income for that year, as shown by this income statement, amounted to \$21,810.29.

Mr. Littman: Certainly it is not a very large company, is it?

The Witness: No.

Mr. Littman: And doesn't affect the ultimate picture very much?

The Witness: I should not think so.

There is included among the gross revenue, the sales to one large industrial customer. As a matter of fact, it is my [fol. 9150] information and belief that a great part of the approximate amount of gross revenue, \$404,000 for the year 1940, came from the sale of gas to this industrial customer and the contract with that industrial customer was supposed to be changed, I believe, among some of the rate schedules which were filed with the Commission more than a year ago and if such change were made, the importance of this company would be somewhat substantially reduced even as unimportant as it is taken into consideration with the total combined picture of all of Panhandle Eastern and its subsidiary companies as they existed after February 6, 1942.

Is that sufficient, sir?

Mr. Littman: That is sufficient for the present, thank you.

(Exhibit No. 195 was received in evidence.)

Mr. Chamberlain: I am not clear, Mr. Watkins, as to just where you obtained your figure in your elimination No. 4 of \$5,460,000. That is said to be the gas sold to subsidiary companies. What companies are included in that?

The Witness: That, sir, would cover the sales only to Michigan Gas Transmission Corporation and Indiana Gas Distribution Corporation and could include any intercompany sales between those two companies.

[fol. 9151] The intercompany transactions between Panhandle Eastern and Illinois Natural, as the witness has previously stated, were made before the data now shown on page 1 of this exhibit in the column headed by the word "Combined" was prepared.

[fol. 9155] LEITH V. WATKINS a witness, having been previously sworn, resumed the stand and testified further as follows:

Direct Examination.

By Mr. Wheat:

Q. Mr. Watkins, I believe at the conclusion of the hearing yesterday afternoon you had just concluded your discussion of Exhibit No. 195.

Will you now pass to the next document which you have prepared, state its title and what it shows, briefly, and then we will ask that it be marked for identification.

A. The next document is a pro forma consolidated income account for the year ended December 31, 1941, adjusted to give effect to Federal income and Federal excess profit tax rates proposed in the recommendation of Secretary of the Treasury Morgenthau on March 3, 1942, before the House Ways and Means Committee and, except for the adjustment required for the provision in Federal

income and excess profits taxes is, in all respects, similar to Exhibit No. 195.

[fol. 9156] (The document referred to was marked Exhibit No. 196 for identification.)

By Mr. Wheat:

Q. Mr. Watkins, the content of Exhibit No. 196 for identification is briefly summarized, is it not, on page 1 of that exhibit? A. That is correct.

Q. And pages 3 and 4 contain certain adjustments. Will you state briefly what those are and the causes or the reasons which led you to make them?

A. Generally speaking, the adjustments on pages 3 and 4 of Exhibit No. 196 for identification are similar to the adjusting journal entries made a part of Exhibit No. 195 except in so far as the adjustments with respect to Exhibit No. 196 for identification deal with the change in the provision for Federal income and excess profits taxes to cause such provisions to conform to the recommendation made by the Secretary of the Treasury on March 3, 1942, before the House Ways and Means Committee and save for the three amounts shown on page 1 of exhibit for identification No. 196 opposite the caption "Charges in Lieu of Federal Income and Excess Profits Taxes" being \$1,010,000 and \$3,400,000 and \$1,285,000, respectively, the information shown in the column headed by the word "Consolidated" on exhibit for identification No. 196, the two exhibits are very much the same.

Q. Mr. Watkins, what causes the difference in the net [fol. 9157] income in the column headed "Consolidated" in Exhibit No. 196 for identification as compared to the same figure in Exhibit No. 195 and what are the figures, respectively?

A. The figures that cause the difference are those included in adjustments Nos. 1 and 2 on page 3 of Exhibit No. 196 for identification and are brought about because of the increased rates and different treatment in the Secretary of the Treasury's proposal made on March 3, 1942, over and beyond the Revenue Act of 1941.

Q. And the respective amounts shown as Net Income after the adjustments and eliminations are what figures?

A. Before giving effect to the proposal made by the Secretary of the Treasury on March 3, 1942, the Net Income, as shown by Exhibit No. 195 on a consolidated basis including the operations of Michigan Gas Transmission Corporation and Indiana Gas Distribution Corporation, newly acquired subsidiaries, was \$5,449,361.60.

Q. That is for the year ended December 31, 1941?

A. That is correct.

Q. And applying the 1941 Federal tax rates?

A. That is correct.

Now, the same figure for the same year and adjusting the Net Income for the proposals made by the Secretary of the Treasury on March 3, 1942, is \$3,594,590.72 as shown by exhibit for identification No. 196.

[fol. 9158] Mr. Littman: The proposed recommendation of the Secretary of the Treasury is, of course, not the present income tax law, is it?

Mr. Wheat: We will stipulate that that is the fact.

[fol. 9160] Mr. Littman: Well, let's see how factual this exhibit is.

First, it has been stipulated that this proposal is not the law?

Mr. Wheat: No, it has not.

Mr. Littman: That it has not yet become the law?

Mr. Wheat: That is better.

Mr. Littman: All right.

Mr. Watkins, if the proposal does become the law, it will not apply to the 1941 income, will it?

The Witness: I should not think so, no, Mr. Littman.

Mr. Littman: It will, of course, apply to the 1942 income, will it not?

The Witness: That is correct. If, however, the income for the year 1942 happens to be precisely the same as the net taxable income for the year 1941 and if the proposal made by the Secretary of the Treasury become the law Exhibit No. 196 for identification would show the effect of that change in the Revenue Act.

Mr. Littman: Obviously, if there were a great reduction ordered effective some time in the year 1942, the amount of taxes applicable to the 1942 income would be decreased proportionately?

[fol. 9161] The Witness: Ordered by the Treasury Department?

Mr. Littman: Ordered by the Federal Power Commission.

The Witness: I presume it would have some such effect, yes.

[fol. 9162] By Mr. Wheat:

Q. Mr. Watkins, will you turn to the next document which you have prepared and state what that is and what it shows, in general?

A. The next document is the balance sheet, per books, of Panhandle Eastern Pipe Line Company and subsidiary companies as of February 28, 1942.

Q. Is that subsequent to the acquisition of the securities of the two other corporations you have mentioned?

A. It is, and is the first balance sheet which has been presented in these proceedings—

Q. (Interposing) And also subsequent to the acquisition [fol. 9163] of the Ohio Fuel Gas Company?

A. I assumed your previous statement included that and my answer was likewise intended to include it.

This proposed document is the first document, as far as this witness knows, in which there has been presented factual information in these proceedings showing the effect of the acquisition of the two new subsidiaries and the transmission facilities from the Ohio Fuel Gas Company.

(The document referred to was marked Exhibit No. 197 for identification.)

The Witness: I am quite sorry that it is necessary for the witness to ask that a correction be made on page 2 of exhibit for identification No. 197. In our haste to prepare and have available some of the material that is being now presented, it was necessary to forward it from our Kansas City office before complete verification had been had, for which reason I must ask that the figures on page 2 under the general heading "Reserves" opposite the caption "Reserve for Amortization and Depletion of Producing Natural Gas Land and Land Rights" in both the columns headed by the words "Combined" and "Consolidated" be changed from the ones now shown to \$466,287.94; and that the figures shown opposite the caption "Reserve for [fol. 9164] Abandoned Leases" be changed from those now shown to \$427,502.68.

These changes do not alter any other figures on this proposed exhibit. The total of the data originally shown is \$893,790.62 and, if you will add the revised figures, you will find that their total is likewise \$893,790.62.

By Mr. Wheat:

Q. Now, Mr. Watkins, will you please explain, in general, what Exhibit No. 197 for identification shows?

A. Exhibit No. 197 for identification is simply a consolidated balance sheet of Panhandle Eastern Pipe Line Company and its subsidiary companies, per books, as of February 28, 1942, with all intercompany transactions eliminated and shows in the column headed by the word "Consolidated" on both pages 1 and 2 the consolidated assets and liabilities of Panhandle Eastern Pipe Line Company [fol. 9165] and all of its subsidiaries as at that date.

(Exhibit No. 197 was received in evidence.)

Q. Mr. Watkins, will you turn to the next document which you have prepared in this matter and state what it is and what it shows?

A. Our next proposed exhibit consists of a pro forma consolidated income account for the twelve months ended February 28, 1942. In order to produce a consolidated income account for such a twelve months' period, it became necessary to make the adjustments defined in Note A on page 2 of the proposed exhibit.

[fol. 9166] (The document referred to was marked Exhibit No. 198 for identification.)

Q. Now, Mr. Watkins, will you go forward with your discussion of Exhibit No. 198 for identification?

A. Exhibit No. 198 for identification produces a consolidated income statement of the company giving effect to the acquisition of Michigan Gas Transmission Corporation and Indiana Gas Distribution Corporation and the properties from Ohio Fuel Gas Company on the basis that the earnings and expenses of those companies had been present throughout the entire twelve months' period on behalf of Panhandle Eastern Pipe Line Company and that the annual interest costs of \$300,000, arising from the financial transactions consummated on February 6, 1942, had been effected March 1, 1941, and that the interest expense shown as applicable to obligations of Michigan Gas Transmission Corporation and Indiana Gas Distribution Corporation to their their parent company until February 6, 1942, would have aggregated the same amount had Panhandle Eastern Pipe Line Company been the parent company and that dividends had been paid by Michigan Gas Transmission Corporation and Indiana Gas Distribution Corporation to the extent of their net income for the twelve months ended February 28, 1942, after giving effect on the part of Panhandle Eastern Pipe Line Company alone, to the estimated increase in Federal income taxes which would have resulted had such interest and dividends been paid by [fol. 9167] Michigan Gas Transmission Corporation and Indiana Gas Distribution Corporation to Panhandle Eastern Pipe Line Company to the full extent of their net income or, perhaps more simply said, this pro-forma consolidated income account assumes a full year's ownership and operation of the properties and business of Panhandle Eastern Pipe Line Company and subsidiary companies as

they existed, on February 28, 1942, and under the same revenue laws then in existence.

Q. Will you pass to your next document, Mr. Watkins?

A. Our next proposed exhibit is that of a pro forma consolidated income account for the twelve months ended February 28, 1942, prepared in exactly the same manner as exhibit for identification No. 198 except that the proposed exhibit, which I take it may be numbered 199 for identification—

[fol. 9168] (The document referred to was marked Exhibit No. 199 for identification.)

The Witness: (Continuing) —is adjusted to show the effect of Federal income and excess profits taxes if the rates proposed in the recommendation of the Secretary of Treasury Morgenthau made on March 3, 1942, before the House Ways and Means Committee, become actualities.

Q. Mr. Watkins, may I ask if, in all other respects, Exhibit No. 199 is similar to Exhibit No. 198?

A. It is, yes.

Q. Mr. Watkins, will you explain the document which has just been distributed?

A. The document just distributed is a comparative statement of gas plant as at December 31, 1939, December 31, 1940, June 30, 1941, December 31, 1941, and February 28, 1942, prepared on the assumption that Panhandle Eastern Pipe Line Company owned Michigan Gas Transmission Corporation and Indiana Gas Distribution Corporation on those respective dates.

[fol. 9169] Q. And also those properties acquired from Ohio Fuel Gas Company?

A. That is true only with respect to the period at February 28, 1942, as will be shown by page 2 of this proposed exhibit under the general heading "Other Undistributed Gas Plant".

(The document referred to was marked Exhibit No. 200 for identification.)

Q. Mr. Watkins, will you proceed with your explanation of Exhibit No. 200 for identification?

A. I am further embarrassed that I must ask that a correction be made in this exhibit for the same reason as the one made in Exhibit No. 197. This change occurs in two places on page 2 of exhibit for identification No. 200.

The last five digits opposite the caption "Total Gas Plant Classified" in the column headed "February 28, 1942," should be—

Q. (Interposing) Just where is this? It is near the bottom of page 2, is it not? A. That is correct.

Q. Will you read first the total figures shown on page 2 [fol. 9170] and then the corrected figure?

A. The figure to be changed is \$78,715,508.01.

Q. What is the corrected figure?

A. The corrected figure is \$78,715,486.88.

Q. Does this proposed correction of yours change the total otherwise?

A. It changes the total opposite the heading "Gas Plant" in the February 28, 1942, column from \$84,998,376.60 to \$84,998,355.47.

Mr. Wheat: Mr. Examiner, these changes are relatively small but I ask that they be made by counsel on their copies of this exhibit and that the reporter be requested to make the changes on the original.

By Mr. Wheat:

Q. Mr. Watkins, I wish you would explain the totals shown at the bottom of the last two columns on page 2 and how they relate to the balance sheet figures which have already been explained by you?

A. Had the cost of gas plant purchased from the Ohio Fuel Gas Company, being \$439,326.08 in the column for gas plant at December 31, 1941, of exhibit for identification [fol. 9171], No. 200, been included in that column, its total would have agreed exactly with the consolidated gas plant figures shown on Exhibit No. 194. The total gas plant, as

shown by exhibit for identification No. 200 at February 28, 1942, is exactly the amount of the consolidated gas plant reflected by Exhibit No. 197.

Q. In other words, the Ohio Fuel Gas Company properties, which were acquired, are included in the figures under the column for February 28, 1942, in Exhibit No. 200 but have not been included in those figures for prior periods?

A. That is correct, sir, and it might be further explained that exhibit for identification No. 200 is simply a detailed statement of the investment in gas plant according to the present Classification of Accounts.

(Exhibit No. 200 was received in evidence.)

Mr. Littman: Mr. Watkins, is my understanding correct that the total distribution plant shown on page 2 of Exhibit No. 200 in the column headed "February 28, 1942", in the amount of \$142,466.11 represents the distribution system of Indiana Gas Distribution Corporation?

[66,9172] The Witness: I think that is entirely correct. I would be surprised if you would find any distribution plant on the books of Panhandle Eastern Pipe Line Company or Michigan Gas Transmission Corporation or Illinois Natural Gas Company.

By Mr. Wheat:

Q. Just to make sure the record is clear—I think you did mention it before—but, on page 2 of Exhibit No. 200 in the column for February 28, 1942, after the words, "Gas plant purchased" under the heading "Other Undistributed Gas Plant", we find the figure \$439,326.08 which figure does not appear in the other columns of the exhibit referable to earlier periods. I take it that that is the figure reflecting the purchase of the property of the Ohio Fuel Gas Company which you have been mentioning?

A. It is.

Q. And that was the purchase price for those properties, was it not?

A. It was.

Q. Mr. Watkins, will you pass to the next document which you have prepared in this connection, state what it is and what it shows?

A. The next proposed exhibit which the witness would like to introduce is that showing the gas plant of Michigan Gas Transmission Corporation stated as at December 31, [fol. 9173] 1931, through December 31, 1941, inclusive.

(The document referred to was marked exhibit No. 201 for identification.)

By Mr. Wheat:

Q. Mr. Watkins, in that connection, have you recently become controller of Michigan Gas Transmission Corporation and, as such, the custodian of its books and records?

A. I have recently become secretary of that corporation, but not controller. It has no controller but, functioning as I do as controller of Panhandle Eastern Pipe-Line Company, I take unto myself the same prerogative as to its subsidiaries.

Q. And the data contained on Exhibit No. 201 for identification was taken from the books of Michigan Gas Transmission Corporation?

A. It was so taken from the books of that corporation under my supervision and has been prepared in conformity with the preparation of Exhibit No. 52 which is a statement of gas plant for Panhandle Eastern Pipe Line Company and subsidiary companies as heretofore explained in these proceedings.

[fol. 9174] By Mr. Wheat:

Q. Is there any further explanation which should be made with respect to Exhibit No. 201 for identification?

A. Yes, I was about to state further that Exhibit No. 201 for identification had likewise been prepared in a manner similar to Exhibit No. 178 and I believe treating with the information shown in Exhibit No. 176 and exhibit for identification No. 201, information with respect to the investment of Panhandle Eastern Pipe Line Company and its subsidiaries other than Indiana Gas Distribution Corporation would be available for any of the periods [fol. 9175] shown in those two exhibits.

Q. Exhibit No. 176 was similar to Exhibit No. 52, was it not, with the exception that the full year 1941 was shown for Panhandle Eastern Pipe Line Company?

A. Was exactly the same except for that difference.

Mr. Littman: We would like to interrogate the witness briefly with respect to one item.

Mr. Watkins, isn't it a fact that you have made no adjustment in Exhibit No. 201 for an item which was referred to in Mr. Spitznagle's original cost study which is in evidence as Exhibit No. 91 and which was referred to in the Securities and Exchange Commission's opinion, Exhibit No. 147, at page 12 as follows:

"The one questionable item is the amount of \$139,424 paid as a fee by Indiana Gas Transmission Corporation, a company subsequently merged into Michigan Gas, to the Columbia Gas Construction Company, another wholly owned subsidiary of Columbia Gas."

You have made no adjustment for that item, have you?

The Witness: Will you please refer to Exhibit No. 200, page 1, the next to the very last line?

[fol. 9176] Mr. Littman: Yes, I have it.

The Witness: You note there a deduction of \$139,500 in the consolidated gas plant as at February 28, 1942, and as at December 31, 1941?

Mr. Littman: That appears on page 2 of Exhibit No. 200.

The Witness: So it does.

Mr. Littman: I find it now.

The Witness: This may be your question, Mr. Littman, if you will grant me the permission to proceed.

Mr. Littman: Certainly.

The Witness: There is in the gas plant of Michigan Gas Transmission Corporation and on its balance sheet an item on both sides of \$139,500 which covers the matter concerning which your inquiry was directed.

Mr. Littman: That amount is included, of course, in the figures shown in Exhibit No. 201?

The Witness: Yes, because this is a statement per books.

Mr. Littman: Per books?

The Witness: That is right.

Mr. Littman: Unadjusted for this item?

The Witness: We have made no disposition of this \$139,500 item. It having been included in the so-called determination of purchase price, it might be necessary, although I am not sure, to obtain the sanction of the Securities and Exchange Commission before adjusting entries, if any, are determined to be necessary or made.

[fol. 9177] Mr. Littman: Yes.

The Witness: That might also involve this Commission.

Mr. Littman: The Securities and Exchange Commission in the next succeeding sentence following the portion of the opinion which I read, referring to this item, said:

"This item represents an intercompany profit."

I think the record is now clear that Exhibit No. 201 is unadjusted for that particular item.

The Witness: That is correct.

(Exhibit No. 201 was received in evidence.)

By Mr. Wheat:

Q. Will you turn to your next document, Mr. Watkins, and state what it is and what it shows?

A. The next proposed exhibit is that of a statement of estimated Federal income and excess profits taxes for the year 1941 and page 1 states such taxes based on the Revenue Act of 1941 for Panchandle Eastern Pipe Line Company, Illinois Natural Gas Company, Michigan Gas Transmission Corporation, Indiana Gas Distribution Corporation and the total resultant taxes.

On page 2, the same information is shown except that the data there has been adjusted to give effect to the rates

[fol. 9178] proposed in the recommendation of Secretary of the Treasury Morgenthau made on March 3, 1942, before the Ways and Means Committee.

On page 3, there is furnished a recomputation of Federal income and excess profits taxes for the year 1941 as explained in page 5 of the proposed exhibit.

Page 4 adjusts such recomputation by the inclusion of the rates proposed in a recommendation made by the Secretary of the Treasury Morgenthau on March 3, 1942, before the Ways and Means Committee.

(The Document referred to was marked Exhibit No. 202 for identification.)

Q. Will you proceed with your explanation, Mr. Watkins?

A. Exhibit for identification No. 202 assumes certain estimated excess profits net income as well as certain estimated normal tax and surtax net income and, with such assumptions, supplies the impact of the taxes for the year 1941 as explained on each of the pages of the proposed exhibit. The pattern is simply that provided by the applicable regulations, and the witness believes is somewhat self-explanatory.

[fol. 9179] A. The next document, sir, is the statement of operation and maintenance expenses for the year 1941 restated to include the operating and maintenance expense of Michigan Gas Transmission Corporation and Indiana Gas Distribution Corporation for the year 1941 and, by the amount shown opposite line 24 on page 4 thereof, furnishes the details of the total operation and maintenance expense of \$3,29,611.53 shown by page 1 of Exhibit No. 195.

(The document referred to was marked Exhibit No. 203 for identification.)

Q. Will you explain anything further you think should be explained with respect to Exhibit No. 203 for identification?

A. Mr. Wheat, this exhibit for identification No. 203 is so similar to two or three of the other exhibits of the same nature that have been introduced, for which explanation has been made and concerning which certain [fol. 9180] requests have been made, that the witness believes it requires no particular explanation unless there be questions.

(Exhibit No. 203 was received in evidence.)

Mr. Littman: I would like to ask Mr. Watkins how the Commission may eliminate, if it desires, from the operation and maintenance expenses shown in Exhibit No. 203 those expenses applicable to Indiana Gas Distribution Corporation, a large part of which relate to purely distribution sales which are not subject to the jurisdiction of this Commission. Can you give us a suggestion in that regard?

The Witness: The insignificant amount of operation of Indiana Gas Distribution Corporation can be eliminated, of course. The witness' viewpoint would be that they are so insignificant that they need not necessarily be dignified by a lot of work to eliminate them.

I believe that would be the company's position, would it not, as far as this particular company's operations are concerned?

Mr. Wheat: Certainly it would, it is so infinitesimal in [fol. 9181] comparison to the volume of business done by the company.

The Witness: If the Commission, however, wishes the information, it can be developed. If it would be our job, however, we would like to be relieved of it.

I might say in connection with Exhibit No. 203 that its introduction is not necessarily an assumption on the part of the company, if I understand correctly, that had these subsidiaries been owned by Panhandle Eastern Pipe Line Company for the full year 1941 that the expenses shown by this exhibit would necessarily have been precisely what the exhibits [shown] them to be.

By Mr. Wheat:

Q. Will you explain what you mean by that?

A. Well, Mr. Wheat, a unified operation might have produced economies or it might, by some hook or crook, brought about increases. You just could not take a dissimilar plan of operation under different management and tack them up one alongside of the other and assume that they would occur in exactly the same manner or fashion under unified operation. So far as we have seen up to this time in trying to merge the operations of Michigan Gas Transmission Corporation and Indiana Gas Distribution Corporation into the plan and procedures of our own operations, there is not going to be too much economy result from that. I am only referring to actual expenses without giving any consideration whatever to the increases that are being experienced by not only the two new sub-[fol. 9182] sidiaries but Panhandle Eastern itself, some statement with respect to which has already been made in this record.

Q. Mr. Watkins, in that connection, you have testified in connection with that matter before. It is true, is it not, that any wage increases or other expenses which have increased in volume during the year 1941 are not reflected on this or any other of these exhibits from the books which contain the 1941 total figures on an annual basis?

A. That is quite true.

Mr. Culton: Mr. Watkins, I believe you stated yesterday that the principal portion of the expenses of the Indiana Gas Distribution Corporation represented purchased gas which has now been eliminated in your consolidated statement?

The Witness: Yes, it is not present at all in this Exhibit No. 203 and, on the fact of the exhibit if you will look at lines 27, 28 and 29, page 2, you will observe there that the distribution expense aggregates a total of slightly less than \$10,000.

By Mr. Wheat:

Q. By the way, Mr. Watkins, these expenses, as shown on Exhibit No. 203 and also as shown on other exhibits of expenses per books, include the expenses suffered by the company during the particular periods mentioned for all

types of business, including both the sales to industrial or direct sales to commercial or domestic and I think you headed one exhibit, "Other Sales", as well as sales to [fol. 9183] gas distribution companies, is that true?

A. That is quite true and I am particularly impressed with your word "suffered" with respect to some of the expenses.

Mr. Littman: Mr. Watkins, you would normally expect that the acquisition by Panhandle Eastern of Michigan Gas and Indiana Distribution would result in economies by reason of the combined operations, would you not?

The Witness: I do not believe, Mr. Littman, in this particular that that is a proper conclusion.

Mr. Littman: Do you agree with the statement made by the President of Panhandle Eastern, Mr. Creveling, in the Annual Report for the year 1941, to the stockholders of Panhandle Eastern in which he stated:

"The effect of the acquisition of these properties by your company would be to increase earnings, remove operating problems and enable your management to deal directly with the distributing organizations in the States of Indiana, Ohio and Michigan."

Do you agree with that statement?

[fol. 9184] The Witness: Wholly, yes.

By Mr. Wheat:

Q. Mr. Watkins, have you also prepared a document headed "Panhandle Eastern Pipe Line Company and Subsidiary Companies—1942 Construction and Retirement Budgets—Summary by Companies" and with additional pages showing data with respect to individual companies?

A. Mr. Wheat, such a document has been prepared and was used in connection with the Board meeting at which the annual routine construction and retirement budget was presented to the Board and the proposals there made were authorized by the Board.

[fol. 9185] (The document referred to was marked Exhibit No. 204 for identification.)

By Mr. Wheat:

Q. Mr. Watkins, will you explain what is shown on Exhibit No. 204 for identification, please state the date of the Michigan Board meeting at which you state this document was offered and approved?

A. I am not at all sure I can give you the exact date of the Board meeting but it was a meeting held in January or February of 1942. It has been our custom and practice at one of the meetings late in the year or in the very beginning of the next year to present to the Board of Directors the annual routine construction and retirement budget.

Q. Will you state what is shown on this document?

A. This exhibit for identification No. 204 is a summary of the 1942 annual routine construction and retirement budgets. It shows that the Board has authorized, as new work for the year 1942, construction items aggregating an estimated total cash expenditure of \$462,600 with estimated additions to gas plant of \$513,500 of which amount \$50,900 is to be taken from the material and supply account.

If I might proceed further without referring to the amounts in each instance as being estimated and if we will understand that they are estimates, it may save some time.

This exhibit for identification No. 204 shows that there have been retirement items authorized involving a cash expenditure of \$500,000 and which, if carried out, will reduce the gas plant by \$256,000 and that the total of the 1942 authorization from a cash standpoint is \$463,100 with the net addition to gas plant of \$257,500 and a net charge to retirement work in progress of \$165,300. This latter figure will eventually find its way to the appropriate reserve account after the retirements have been consummated.

The summary sheet, being page 1 unmarked, shows likewise that of certain estimated construction expenditures

authorized in the year 1941, unfinished at December 31, which are expected to be carried out in 1942, involve a cash expenditure of \$8,080,400, and estimated increase to gas plant of \$8,070,125. The detail of these latter amounts is shown on the very last page of Exhibit No. 204 for identification.

[fol. 9187] All of this work is underway and will unquestionably be completed if it is possible to obtain the materials necessary. As an indication of the progress in that respect, the witness would like to refer to the next document he proposes to offer.

Mr. Wheat: Yes. I think possibly we might have that marked for identification as Exhibit No. 205, if that is agreeable, Mr. Examinee.

(The document referred to was marked Exhibit No. 205 for identification.)

By Mr. Wheat:

Q. Will you state what you had in mind in explanation of the document marked Exhibit No. 205 for identification?

A. The 1941 carry-overs, as we term them and as shown by exhibit for identification No. 204, amounted to \$8,080,400 at the time this annual routine construction and retirement budget was presented to and approved by the Board of Directors.

Q. You mean Exhibit No. 204 for identification?

A. If I used another number, 204 is correct.

Q. You did not use any number and I just suggested that we identify it.

A. Since its preparation, that is, exhibit for identification No. 204, and since the approval of the proposals therein contained were had by the Board of Directors, certain expenditures have been made on these carry-overs and we [fol. 9188] believe in [in] exhibit for identification No. 205, it will be observed that we estimate the unfinished amount of projects approved in the year 1941 which were unfinished at December 31, amounted to \$7,433,000 and that the unfinished work on those projects at February 28, 1942, involved an estimated amount of \$5,396,000 which shows a substantial expenditure since December 31, 1941, and

likewise a substantial expenditure for additional investment in gas plant since the annual routine construction and retirement budget for the year 1941, which included carryovers amounting to \$8,080,000, was presented to the Board.

Q. And it is a fact that that construction is continuing to go forward as rapidly as material and delivery can be had?

A. That is a fact, yes, sir.

(Exhibits Nos. 204 and 205 were received in evidence.)

Mr. Littman: Mr. Watkins, I refer you to the last page of Exhibit No. 204. I note that the larger part of the additions to gas plant for the year 1942 comes under the heading of "Expansion" and totals \$7,572,800. Isn't it a fact that the amount of \$7,572,800 is being expended for the purpose of acquiring new markets and for the purpose of serving new markets to be acquired in the future?

[fol. 9189] The Witness: As far as I know, Mr. Littman, your assumption is partially correct although not wholly correct.

Mr. Littman: To what extent is it not correct?

The Witness: There are certain expansions or strengthening of facilities on the existing lines in the State of Illinois which may not, of necessity be required for the addition of new markets.

Mr. Littman: That would be rather small?

The Witness: I would not say so at all, sir. That, I believe, is already in the record and there are other witnesses who no doubt can explain that to you more properly than the present one.

By Mr. Wheat:

Q. May I ask a question that might bring that out.

Mr. Watkins, are you referring in what you have just said to the items on the last page of Exhibit No. 204 headed as follows:

"Havth Loop, Louisburg Loop, Houstonia Loop, Centralia Loop, Mississippi River Crossing, Pleasant Hill Loop, Illinois River Crossing, Glenarm Loop and Tuscola Loop"?

A: Mr. Wheat, I am not an engineer. I am not even an operating man. To the extent that these expenditures are absolutely required for new business or to maintain the status quo of the existing facilities, I am very much afraid I cannot be of too much help to you.

[fol. 9190] Q:—But you have testified that the Board has approved these various items?

A: Yes. They have not only done that but the work is underway.

Mr. Littman: And is it expected that this work will continue to completion notwithstanding the fact that the War Production Board issued an order to which reference has been made in this proceeding as Order No. L-31?

The Witness: I should say that is the fact. As to what effect, so-called Order L-31 would have on this construction or the company's ability to get materials or any other pronouncement made by any of the defense industries, your present witness is not prepared to answer you.

Mr. Littman: You have not shown in any of your exhibits, particularly the pro forma exhibits, the increased revenues to be derived from these new markets, have you?

The Witness: No. I believe, however, there were some presentations made in previous sessions which might have some of that information in them. That, however, is a guess on my part.

[fol. 9225] Mr. Littman: May I take up one matter, however, before Mr. Chamberlain proceeds? I would like to identify and offer certain exhibits with which I am sure Mr. Watkins is familiar.

[fol. 9226] I would like to have marked for identification a document entitled, "Financial Statement of Panhandle Eastern Pipe Line Company and Subsidiary Companies for Period Ended December 31, 1939."

Trial Examiner: This will be marked for identification as Exhibit No. 206.

(The document referred to was marked Exhibit No. 206 for identification.)

Mr. Littman: I would like to have marked for identification as Exhibit No. 207 a document entitled, "Financial Statement of Panhandle Eastern Pipe Line Company and Subsidiary Companies for Period Ended December 31, 1940."

Trial Examiner: This will be marked for identification as Exhibit No. 207.

(The document referred to was marked Exhibit No. 207 for identification.)

Mr. Littman: I ask that a document entitled, "Financial Statement of Panhandle Eastern Pipe Line Company and Subsidiary Companies for Period Ended December 31, 1941", be marked for identification as Exhibit No. 208.

Trial Examiner: It will be so identified.

(The document referred to was marked Exhibit No. 208 for identification.)

Cross Examination—Resumed

By Mr. Littman:

[Vol. 3227] Q. Mr. Watkins, I hand your Exhibits Nos. 206, 207, and 208 for identification, and ask you whether those were furnished by you to Mr. Dunn of the staff of the Federal Power Commission at Mr. Dunn's request.

A. They were.

Q. And do those financial statements correctly reflect the books and records of Panhandle Eastern Pipe Line Company and subsidiary companies and do they correctly show what they purport to show?

A. It is my belief they do except for the exhibit marked for identification No. 207 which I observe has the following notation on page 1 thereof:

"This statement complete except for Central Distributing Company."

Q. Will you explain the circumstances surrounding the statement which you just read?

A: Panhandle Eastern Pipe Line Company disposed of its former subsidiary, Central Distributing Company, in the early part of 1941 and, without having made a previous verification, it is my belief that the notation just referred to on Exhibit for identification No. 207 came about through the fact that the financial statements of Central Distributing Company were delivered to the present owners of those companies along with all of the other corporate records for that company and, therefore, is not in this particular copy of the financial statement.

[fol. 9228] Q: Central Distributing Company is a company which engages wholly in distribution system activities, is it not?

A: That is correct, sir.

Q: And with that single exception, these financial reports are complete and do reflect the books and records of Panhandle Eastern Pipe Line Company and subsidiary companies for those years?

A: With that exception, your statement is correct.

[fol. 9247]

WILLIAM G. MAGNIN, a witness called by and on behalf of the Commission, having been first duly sworn, was examined and testified as follows:

Mr. Laffman: Mr. Examiner, before I interrogate this witness, I should like to make a very brief statement with respect to the subject matter concerning which I propose to inquire of the witness.

Panhandle Eastern has presented an exhibit which has [fol. 9248] been identified as Exhibit No. 38 from which the claim is made that Panhandle Eastern Pipe Line Company and subsidiary companies are entitled to have included in the rate base, for purposes of this proceeding, the sum of five and one-half million dollars for what is called interest, ad valorem taxes, and operating expenses attributable to unused capacity, which is alleged to have been present in the pipe line system between April 1, 1932, and September 30, 1936.

On one or two occasions counsel for Panhandle Eastern have referred to this exhibit as the basis for a claim for going concern value.

[fol. 9249]

Direct Examination

By Mr. Littman:

Q. Will you please state your full name?

A. William G. Maguire.

Q. What is your address?

A. Legal residence or where I spend most of my time?

Q. Both.

A. Well, Fredericksburg, Virginia; and 120 Broadway, New York.

Q. What is your present business or occupation?

A. I am president of Missouri-Kansas Pipe Line Company.

Q. You are under subpoena issued by the Federal Power Commission to testify in this proceeding?

A. I am.

Q. And your appearance here is in response solely to that subpoena, is it not?

[fol. 9250] A. It is.

Q. Are you a director of Panhandle Eastern Pipe Line Company?

A. I am.

Q. How long have you been a director in that company?

A. I was a director from some time in October, 1930, until some time in March, 1932, and from some time in October, 1937, until the present date.

Q. I believe you stated a moment ago that you were the president of Missouri-Kansas Pipe Line Company which has been sometimes referred to in this proceeding as Mokaan?

A. That is right.

Q. How long have you been president of that company?

A. Since some time in September, 1937.

Q. Had you, previous to that time, occupied an office in that company?

A. No office.

Q. Mokaan is the owner of 339,450 shares.

A. (Interposing) It is four hundred seventy-five.

Q. 339,475 shares?

A. That is right.

Q. (Continuing)—of the common stock of Panhandle Eastern Pipe Line Company?

A. That is correct.

Q. And that represents 42 percent of the outstanding [fol. 9251] common stock; is that right?

A. I think it does.

Q. And is it a fact that Columbia Oil and Gasoline Corporation owns beneficially 440,326 shares of the common stock of Panhandle Eastern?

A. That is a subject we are disputing in the Federal Court in Philadelphia, whether they own that many shares or not.

Q. I am reading at this moment from page 69 of Exhibit 145, which is the company's registration statement No. 2-4919, filed before the Securities and Exchange Commission, which also shows that Columbia Oil and Gasoline Corporation holds 50.1 percent shares of the common stock. You are familiar with that registration statement, are you not?

A. I am familiar with the registration statement; yes.

Q. But there is some dispute about the matter?

A. Very decidedly.

Q. Now, the balance of the common stock is distributed in the hands of the public, isn't it?

A. That is right.

Q. So that Mokan is at present and for some time, I take it, has been a minority stockholder in Panhandle Eastern?

A. That is what—yes, a minority—they are not the [fol. 9252] controlling stockholder at the moment.

Q. Who is the controlling stockholder?

A. Well, the S. E. C. says Columbia Gas and Electric Corporation.

Q. Did Mokan at one time own all of the common stock of Panhandle Eastern?

A. That is a subject for dispute, too, but I say yes, they did at one time.

Q. Isn't it a fact that Mokan organized Panhandle Eastern Pipe Line Company?

A. Yes, sir.

Q. That was in what year?

A. As Panhandle Eastern, I think some time in April of 1930.

Q. Prior to that time the name of the company was what?

A. I think Texas Interstate, or Interstate Natural Gas Company. I am not sure. I wasn't connected with it at the time.

Mr. Wheat: Texas Interstate Pipe Line Company.

The Witness: Texas Interstate Pipe Line Company.

By Mr. Littman:

Q. Well, it was that company which was organized originally in 1929 by Mokaan; isn't that correct?

Mr. Wheat: Pardon me, Mr. Littman. I am told that I am not quite correct in the statement I made. A first [fol. 9253] there was no word "Texas" there, but that is all shown in Exhibit 145.

Mr. Littman: Yes.

Mr. Wheat: I just didn't want my statement to go on the record being somewhat incorrect.

Mr. Littman: Well, those were merely name changes, weren't they? May we not agree on that?

Mr. Wheat: I suppose they were. I don't know. Mr. Maguire can probably say.

The Witness: I would say not.

By Mr. Littman:

Q. At any rate, you are aware, are you not, of the fact that Mokaan caused Panhandle Eastern Pipe Line Company to be formed and organized?

A. I don't think there is any doubt about that.

Q. No doubt about that?

A. Not in my mind there isn't.

Q. Until what date in 1930 did Mokaan control Panhandle Eastern?

A. That is kind of a tough one, too, but I would say October 23, I think that was the closing date with Columbia Gas and Electric Corporation.

Q. Up to that time there is no question but that Mokan was in the driver's seat, so to speak, in so far as Panhandle Eastern is concerned?

A. I don't think there is any—well, let it go at that. Yes, I would say so.

[fol. 9254] Q. And after that time, who controlled Panhandle Eastern?

A. Well, we thought that it was going to be a 50-50 control. That is, I did.

Q. Who do you mean by "we"?

A. Well, Mokan, but I will specify now what I thought at the time. I was not connected with Missouri-Kansas except in an advisory capacity. I was paid just like a lawyer would be paid. When I made the original agreement with Mr. Gossler, and I am the one that did it, in 1930, there was a distinct understanding that they would have four directors, we would have four directors, and there would be an odd man.

Q. By "they" you mean Columbia Gas and Electric Corporation—

A. (Interposing) I mean Columbia Gas, yes.

Q. (Continuing) interests?

A. Well, the option they had ran to Columbia Oil and Gasoline, but all our dealings were with Columbia Gas and Electric Corporation, officially. And I understood that the bonds that were issued, 20,000,000, were to be sold publicly. I found out some time in November of 1930 that Columbia Oil and Gasoline Corporation had purchased the bonds directly from the National City Company.

Q. Now, do you recall an agreement dated September 17, 1930, which has been referred to as a tri-party agreement [fol. 9255] between and among Mokan, Columbia Oil and Gasoline Corporation, and the National City Company?

A. I do.

Q. Well, then, it was after October 23, 1930, or thereabouts that Missouri-Kansas ceased to control Panhandle Eastern, or will you state the fact?

A. They most certainly did cease to control. Within about two weeks after the closing date of the agreement, we learned of Mr. George Howard, who had been selected as the odd man; he had been elected not only a member of

the Board of Columbia Gas and Electric Corporation, but a member of the Executive Committee, as well.

Q. You referred to Mr. Howard as the odd man.

A. That is right.

Q. What do you mean by that?

A. Well, if there had not been an odd director, if there was—if both parties disagreed all the time, there would have to be an arbiter of some kind, wouldn't there?

Q. I see. And on and after October 23, 1930, who did control Panhandle Eastern, in fact?

A. Columbia Gas and Electric Corporation.

Q. When did you first become interested in the pipe line project now owned by Panhandle Eastern?

A. March of 1930.

Mr. Wheat: When you were speaking, Mr. Littman—[fol. 9256] just so that we may be clear—when you said "you" in that question, do you mean the witness or the company, which he was then representing?

Mr. Littman: I meant the witness.

Mr. Wheat: The witness.

By Mr. Littman:

Q. Did you so understand my question?

A. Yes.

Q. As to when you first became interested.

A. That is correct.

Q. Did you testify before the Federal Trade Commission in November of 1935, in that Commission's investigation of certain electric power and gas utility companies, particularly with respect to Panhandle Eastern Pipe Line Company and associated companies?

A. I did.

Q. Mr. Maguire, I shall read from portions of the transcript of those proceedings contained in Document 92, Part 82, of the Senate, of the 70th Congress, First Session, which document was filed with the Secretary of the Senate on November 13, 1935, and which is entitled "Utility Corporations—letter from the Chairman of the Federal Trade Commission meeting in response to Senate Resolution No. 83, 70th Congress, a monthly report on the electric power and gas utility inquiry—No. 82, history of natural [fol. 9257] gas and natural gas pipe lines in United States,

and reports on Columbia Engineering and Management Corporation, Colorado Interstate Gas Company, Canadian River Gas Company, Mississippi River Fuel Corporation," and I shall hand you a—I herewith hand you a copy of that report so that you may follow portions of your testimony which I propose to read. (Handing)

A. All right, sir.

Q. I trust you will correct me at any time, if I should misread or misspeak myself, as I occasionally do.

A. All right, sir.

Q. I refer you to page 301, et seq., of this document which is a transcript of your testimony before the Federal Trade Commission for the afternoon session of November 12, 1935.

I shall start with the seventh paragraph.

A. On 301?

Q. On page 301.

A. Yes.

Q. You understand I shall endeavor to read only those portions of that transcript which I feel are relevant to this present inquiry.

A. All right.

Q. "Question: Did you, after concluding these firm commitments with the North American interests, North American Light and Power, then arrange to see Mr. [fol. 9258] Gossler, in New York?

"Answer: I did."

Before proceeding with the next question, I am going to ask you to identify for the purposes of this record Mr. Gossler.

A. Mr. Gossler at the time of which Mr. Littman speaks was president of the Columbia Gas and Electric Corporation.

Q. I shall continue reading.

Next question: "Can you say about when it was that you saw him first?

"Answer: I saw Gossler early in May, but I talked to him on the telephone, oh, I should say three or four days after my first visit with Chamberlain and Studebaker. I

can place the exact date for you. It was the day that United Corporation trade was made, and I talked to him on the phone. He told me why he could not see me that day, but would I be good enough to see Munroe, and if I could stay over until the next day, he would like to see me."

I shall ask you to state the year in which you saw Mr. Gossler?

A. May, 1930.

Q. Will you please identify for us Mr. Munroe, to whom you referred in your testimony?

A. Mr. Charles A. Munroe, at that time, I believe—I am quite sure—was a director and a member of the committee of Columbia Gas and Electric Corporation.

Q. Now, at this time, to wit, May of 1930, Mekan was in control of Panhandle Eastern?

A. It was.

Q. I shall continue reading your testimony:

"Question: Did you then see Munroe?

"Answer: I did.

"Question: Will you tell us the substance of your conversation with Mr. Munroe?

"Answer: Well, I knew Mr. Munroe rather well, and he told me that I had undertaken—"

A. Wait a minute. "And I told him."

Q. I am sorry, and I told him that I had undertaken a commission from Missouri-Kansas Pipe Line Company; told him what I knew about Missouri-Kansas Pipe Line Company; told him that we were going to build a line to Indianapolis."

A. "At least to Indianapolis."

Q. "At least to Indianapolis."

A. That is very important, that "at least."

Q. "He told me, in his own way, that I was crazy."

"Question: That you were what?

"Answer: Crazy; and that Parish was perhaps crazier, because, if he had as much money as I said he had, that he ought to keep it, and stay out of the natural-gas busi-

[fol. 9260] ness, and that, anyway, Indiana was their territory. I asked him how he figured that; as far as I knew, the only place, the only towns that Columbia served in Indiana was a little gas up at Muncie. Well, he said that that didn't make any difference, Indiana was their territory."

Now, will you explain what you mean by the term "their territory"? Do you mean Columbia territory?

A. That is what Mr. Munroe meant.

Q. I shall continue.

"Question: You mean, to be exploited when they got around to it?

"Answer: That is it.

"Question: Although they were not then serving it?

"Answer: That is right; and we talked about Indianapolis. He, of course, knew that—

A. That I knew about."

Q. That I knew about the Citizens gas situation. We discussed that, at length, and he was distinctly hostile.

"Question: Did you go back to Chicago without seeing Mr. Gossler on that occasion?

"Answer: I don't recall, but I saw Mr. Gossler within two or three days, now. Whether I went back to Chicago, in the meantime, I do not know, but I do not think that I did, but anyway, Mr. Gossler called me at my hotel, and asked me, would I come down to see him and discuss the [fol. 9261] subject that I had discussed, the previous day or so, with Mr. Munroe."

Did you give that testimony which I have read, before the Federal Trade Commission?

A. I did.

Q. I now refer you to the middle of page 303.

"Question: When you arrived in New York, after that trip, did you get in touch with Mr. Gossler?

"Answer: I did."

Now, will you please fix the date, approximately?

A. Lord, that is 12 years ago.

Q. Well, in what year?

A. No, 1930.

Q. Very well.

A. Early in 1930.

Q. Early in 1930.

A. In May of 1930.

Q. That is close enough.

A. Yes.

Q. "Question: Did you discuss with Mr. Gossler the subject matter of your conversation previously, with Mr. Munroe?"

"Answer: Yes. He brought it up, and said it was very interesting; but it was ill-advised; that he had spent some twenty-odd years building up the Standard and Natural Gas Securities, and that a venture of this kind would just [fol. 9262] tend to destroy his work of 20 years; I could not see why and I told him why I could not see why.

"Question: What did you tell him?"

A. May I make a suggestion right here? There must be a misprint.

Q. Very well. Make any correction that—

A. The Standard—I don't know what that means—the "Standard and Natural Gas Securities." What I must have said was "Standard Natural Gas Securities."

Q. Without the "and"?

A. Yes, without the "and." Without the separation.

Q. Thank you. And feel free to interrupt at any time to correct the transcript.

A. All right.

Q. "Question: What did you tell him?"

"Answer: That we could sell the output of the line, that we had very cheap gas, that we could sell him the gas at Indianapolis, or east thereof; a little cheaper, probably, than he was buying it in the field, if we had to.

"Question: Was anything said on that occasion about territory?"

"Answer: Yes. He reiterated that Indiana was their territory."

Question: The whole of the State, or some part of it?

Answer: That he had made arrangements with Mr. [fol. 9263] Insull; the time was not ripe, yet, but that the Midland United business was his business, and that we should stay out of it.

Question: Midland United was Insull, was it?

Answer: At that time, yes."

A. Now, if I may interrupt.

Q. Very well.

A. This is not as clear as it should have been. That is about the time that he made the famous deal with the—I think it was Reserve Gas Company or the Hope Natural.

Q. By "he" you mean whom?

A. Gossler. And he had paid 26½ cents at the river for gas. That is what I meant. At the time we could sell it to him cheaper than he could buy it in the field. He was buying it at 26½ cents.

Q. Where was he buying it at that price?

A. It was the division, the imaginary line, the Ohio River between Ohio and West Virginia, the Reserve Gas.

Q. By "he" you mean Gossler?

A. That is right. Columbia Gas is what I mean when I am talking about the field.

Q. I see. Now, will you please turn to page 305 about one third of the way down the page.

Question: Do you recall going to New York about that time, for the purpose of an appointment with Mr. Barthold?

Answer: Yes."

[fol. 9264] Will you please identify him for the record?

A. Mr. Barthold was vice president of the Consumers Power. He was vice president of the Commonwealth and Southern Corporation, and was president of the Central Illinois Light, and I don't recall what the Springfield property was called. The name has since been changed, and they are all in one. That is, the properties in Illinois, Springfield and Peoria is now Central Illinois Light.

Q. I shall continue reading your testimony.

Question: What did the appointment relate to?

"Answer: The contracts for Peoria and Springfield, and we had, in the meantime, gone into the Peoria and Springfield markets, and had tied up most of the industrial consumers, particularly the Keystone Steel & Wire.

"Question: Do I understand that Mr. Barthold's company, there at Peoria, made an agreement to take gas from Missouri-Kansas?

"Answer: Yes, sir, they had a verbal agreement.

"Question: Did you report to Mr. Gossler the successful conclusion of your negotiations with the North American Light & Power people?

"Answer: I did.

"Question: What did he have to say about it?

"Answer: He thought the North American Light & [Vol. 9265.] Power people made a great mistake.

"Question: Is that what he said, or is that what he thought?

"Answer: No, that is what he said.

"Question: Did he enlarge on that, as to why they had made a mistake?

"Answer: Yes; that they would put the 'hall mark,' I think was his exact expression, 'put the hall mark on Missouri-Kansas' enterprise, and it was a 'raid', he considered it a 'raid', and if such things happened, he did not know where it would stop."

Now, have I read correctly thus far that portion of your testimony?

A. You certainly did.

Q. Now, will you please fix the approximate time that this latter portion of your testimony related to?

A. That should be around the early part of June, 1935.

Q. 1935?

A. Yes; 1930, I mean. I am sorry.

Q. You were testifying before the Federal Trade Commission in 1935.

A. That is right.

Q. Now, I ask you to turn to page 306 about the middle of the page.

Q. ~~Question:~~ During the time that you were carrying on [fol. 9266] those negotiations with Mr. Barrows, were you also in touch with Mr. Gossler, in New York?

A. Answer: I was.

Q. Question: And about when was that, now?

A. Answer: This would be the latter part of May. We are about there, now. By that time, Mr. Gossler, I believe, was convinced the line was going to be built. He then wanted to buy gas, or suggested that if a proper price could be made, that they would take gas. Also about that time is when I introduced Parish to him, the first time.

Now, will you please fix the year in which this occurred?

A. 1930.

Q. And will you please identify for us Mr. Parish?

A. Mr. Parish at that time was president of Missouri-Kansas Pipe Line Company.

Q. And he was one of the men who conceived of this project, was he not?

A. You mean of Panhandle Eastern?

Q. Yes.

A. No, he did not.

Q. Well, what was his connection with Panhandle Eastern, just briefly, so that the record may identify him.

A. He was the president of Missouri-Kansas Pipe Line Company and he was the president of Panhandle Eastern Pipe Line Company at that time, but that is not your [fol. 9267] question. You asked: did he conceive of it.

Q. Yes.

A. He didn't.

Q. He did not?

A. He did not, no.

Q. Well, he certainly attempted to promote it, did he not, at that time?

A. Oh, yes. He was—maybe I misconstrued your question.

Q. I think you were following my question pretty carefully.

A. All right.

Q. He did not conceive the enterprise, but he did promote it?

A. He did not conceive the particular enterprise that you were talking about.

Q. What enterprise did he—

A. (Interposing) He intended to go north. He raised money, I since had learned, by selling stock on the open market. He purchased the small gas reserves down in Texas back, I think, in '29. Perhaps some early in '30, and his idea at that time was to build a line that would closely duplicate what is now the Northern Natural Gas Company.

Q. Natural Gas Pipe Line Company of America?

A. No., the Northern Natural.

[fol. 9268] Q. Northern Natural?

A. That is the line up to Des Moines, Omaha, and so forth up to the Twin Cities.

Q. In other words, it was originally planned that the pipe line company would go up in that direction?

A. That is correct.

Q. Will you state for the record briefly why the line did not go up in that direction?

A. Well, he encountered a great deal of difficulty, but I thought a better place to build the line was to build it east where they used gas.

Q. In other words, build it as it is now built?

A. That is correct.

Q. And that, of course, came about?

A. It did.

Q. Very largely through your efforts, did it not?

A. I think the record will show that.

Q. The record will show that that is a fact?

A. I think it will.

Q. And as a matter of fact, you negotiated certain gas sales contracts that were entered into between Panhandle Eastern and Missouri Power and Light Company and Illinois Power and Light Company?

A. The company that I was president of at that time handled those transactions.

[fol. 9269] Q. I shall continue reading your testimony where we left off. A. All right, sir.

Q. "Question: And would you say that was along early in June, 1930, or thereabouts?"

A. "Answer: It was either the latter part of May, or early in June."

A. What page are you on?

Q. 306, near the bottom.

A. All right. I have it now. And then the next is:

"At this meeting—"

Q. That is right. A. All right.

Q. "Question: At this meeting with Mr. Gossler, when you introduced Mr. Parish, what was the subject or scope of the conversation?"

A. "Answer: Mr. Gossler told Mr. Parish that Indiana was their territory, told him again. He said that they had been considering building a line east from the Mid-Continent field, and he opened the drawer of his desk and said, 'Here is the line'; and he said they had a lot of gas in Arkansas, northern Arkansas, and that he was going to build that line over to Cincinnati, and there was no use of our building a line across Missouri and Illinois, when he was going to do approximately the same thing. I [fol. 9276] pointed out that Josh Cosden was about the only one I knew who said that there was any gas in northern Kansas in large quantities—"

A. Northern Arkansas.

Q. "Northern Arkansas in large quantities, and that tied up with Mr. Cosden. He said that did not make any difference, they had plenty of gas, and they were going to build the line; there was no need of duplication of effort. I pointed out that our line certainly went through a better industrial territory, and that his line would go through the Ozarks and Egypt, and southern Illinois, and I did not quite know who he was going to sell the gas to. He laughed about that and said maybe he could join us, on some fair sort of proposition."

Q. "Question: Was there a time, about then, when Mr. Gossler discussed with you the effect of this projected

line of the Missouri-Kansas upon the industry as a whole in the Middle West? Answer: Yes, sir.

Question: Will you state what he said, in that connection?

Answer: He said it would demoralize it; that it constituted a 'raid.' I asked him how. He told me we went within a few miles of Kansas City, the projected line will go within a few miles of Kansas City; that was Doherty's territory; that we would go within a few miles of St. [fol. 9271] Louis, and that was Christy Payne's territory; we were projecting a line to Peoria, and that was the Chicago line's territory; we were going over into Indiana, and that was his; that it should be stopped; that it would influence the price of gas securities and be generally demoralizing."

Now, who is the Mr. Doherty to whom you referred?

A. He is dead. He was Henry L. Doherty, Cities Service Company.

Q. And who is Christy Payne?

A. Mr. Christy Payne is retired. He was vice president and treasurer of the Standard Oil Company of New Jersey.

Q. And to what line did you refer by the "Chicago line"?

A. That is called now the Natural Gas Pipe Line Company of America.

Q. Thank you.

I shall read on.

Question: I am showing you a page of the memorandum that you previously identified, and I will ask you whether you can give us any more details of that conversation?

Answer: Yes. I recall very well, now, but I have already given you part of that.

Question: All right.

Answer: He used his favorite expression, that 'We [fol. 9272] all live in glass houses,' and told me that the Standard Oil folks and Cities Service were very much

disturbed by this Panhandle-Eastern line; also, Mr. Insull. They were disturbed about their rate structure; that he thought he could work out that disturbed situation better than we could, if he went along with us; and he cautioned me to preserve the utmost secrecy about any talks or dealings that I had had with him on the subject; that he would try to work it out.

"Question: Did he say why he wanted it kept secret?

"Answer: He was disturbed. He wanted us to stay out of Indiana; he had a deal with Mr. Insull for the Midland United. There was some question of whether the Chicago line would be built down in Indiana, or sell gas to Midland United at the State line; that he wanted that; that Mr. Insull and Mr. Doherty had always maintained that he should stay east of the Ohio-Indiana line.

"Question: Did he make any statement with reference to the strategic qualities of this line, based on the map?

"Answer: Yes. He told me, if I would take a map of the Central United States and a pencil and a ruler, I could not draw a line to raise more hell than that one.

"Question: Was there any discussion on that occasion with reference to the Detroit market?

"Answer: He knew that I had a tentative agreement [fol. 9273] with the Great Lakes Steel Co., at Detroit. I had made them a price on gas for their open hearths and soaking pits, at Detroit, and had gotten a commitment from them.

"Question: Did you discuss it, on that occasion?

"Answer: Yes, we did, and that was also his territory.

"Question: Was there any statement with reference to whether or not other interests also claimed that territory, the Detroit market?

"Answer: Yes. Mr. Doherty at that time was considering building a Chicago line over to Detroit, through southern Michigan.

"Question: Did Mr. Gossler on that occasion caution you against any particular individual, as not being safe to

give the information to, that you were discussing between you?"

The latter portion is not germane here. But have I correctly read from your testimony, and was that a part of your testimony before the Federal Trade Commission?

A. There is not much doubt about it. I will say this: This is the first time I read it, though, in seven years. Yes, I gave that testimony.

Q. I will ask you to turn to page 331 of the Federal Trade Commission report No. 82, at the top of the page, by Mr. Wooden. A. I have it.

Q. Question: At this conference that you have just [fol. 9274] described, Mr. Maguire, attended by a considerable number of people, were any statements made with reference to the matter of division of territory?"

I am going to ask you to fix the approximate time of that conference.

A. Just a minute. I have got to read back.

.

By Mr. Littman:

Q. Mr. Maguire, have you checked the transcript to refresh your recollection of the date of the conference to which I referred?

A. In September of 1930. I think it was at the Savoy Plaza, a hotel.

Q. I shall continue reading from page 331 of the transcript of testimony before the Federal Trade Commission:

Answer: Mr. Munroe wanted Missouri-Kansas to stay out of the—

Question: Do not say what he wanted. You may say [fol. 9275] what he said.

Answer: Oh. Mr. Munroe demanded that Missouri-Kansas stay out of the State of Indiana. I said we were building a line in Indiana, then, to Terre Haute, from Evansville, north; we were already operating in the State, or about to, and that we would not stay out of Indiana.

"Question: Was that the extent of the statements that were made regarding the subject?

"Answer: The extent of the statement I made.

"Question: I am asking you what anybody at that meeting said on the subject.

"Answer: Russell spoke up and said we were entitled to an operating situation.

"Question: Meaning by 'we,' whom?

"Answer: Well, Russell was speaking, that Missouri-Kansas was entitled to an operating situation; that he thought that my statement was right."

I would like to have you identify Mr. Russell for us.

A. Mr. Russell at that time was vice president of the National City Company of New York, the people that bought the Panhandle bonds.

Q. And that company was one of the parties to the September 17, 1930, contract? A. That is right.

Q. I shall continue reading:

[fol. 9276] "Question: Does that cover the full extent of the statements made on the subject of that meeting, as you now recall them?

"Answer: Well, a little later on, when the question of price of gas to be bought by Missouri-Kansas and by Columbia, came up, and there was a question of where we were going to sell our 20,000,000 feet arose.

"Question: That was the 20,000,000 feet provided for in the contract?

"Answer: September 17—in the proposed contract.

"Question: Had it also been provided for, in the option contracts, during the summer?

"Answer: No. Columbia, at that time, were insisting on 30,000,000 feet a day, at the terminus of the line, and covered it by a letter of Mr. Pew to Missouri-Kansas, all through the negotiations. Mr. Munroe asked Mr. Parish, within my hearing, not to do anything to disturb Mr. Russell's situation in Indiana. Parish told him that he would

consult with them, or some words to that effect—an evasive answer.

“Question: Do I understand that, following the September 17 contract, you became a member of the board of directors of the Panhandle-Eastern? Answer: I did.

“Question: Who were the other members of that board, [fol. 9277] at the time you were?

“Answer: At the start?

“Question: Yes..

“Answer: On the Columbia side, Mr. Crawford, Mr. Gossler, Mr. Fred Crawford, and Mr. Munroe. On the Missouri-Kansas side, Mr. Parish, Mr. duPont, Mr. Russell, and myself; and Mr. George H. Howard, as the so-called ‘neutral director’.

“Question: Was that Mr. Russell, of the National City Company? Answer: Yes, sir.

“Question: You attended meetings of the Board of Directors during the period from late 1930 and through 1931? Answer: I did.

“Question: In a general way, was there considerable difference of opinion between the various factions on the Board, as to the proper policy to be followed?

“Answer: From the very first meeting.

“Question: What were the differences? What did the differences relate to?

“Answer: Started originally on territorial differences, and Missouri-Kansas had taken several industrial contracts in Indianapolis for gas. That was the first difference. The second meeting, as I recall it, was a question of the extension from the then terminus of the line to Detroit, the proposed extension.

[fol. 9278] “Question: Tell us about that. Answer: —”

A. “About that last.”

Q. “—about that last.

“Answer: Gossler stated that it would be desirable to extend the line to Detroit, so that the Columbia—”

A. "As that."

Q. "—as that the Columbia, Cities Service, Consumers Power, and possibly Seagraves should have an interest in it, and I recall asking him, 'Where do we get off?' He said we were not entitled to any interest."

"Question: Did this occur at the meeting of the Board of Directors? Answer: Yes, sir."

"Question: And when would you say that came up, first?"

"Answer: I would say in a November meeting—November or December, 1930."

"Question: 1930? Was that also about the time that Seagraves was projecting a line toward Detroit from Kentucky?"

"Answer: No. It was after he had sold out."

"Question: Very shortly after, wasn't it?"

"Answer: A month or so."

"Question: Did Mr. Gossler undertake, on behalf of the Panhandle, to negotiate for service or supply to Detroit?"

"Answer: Well, of course, he had his 30,000,000 feet [fol 9279] that he had contracted for."

"Question: Did you negotiate for Detroit service in any personal way? I mean, did you personally negotiate for a supply at Detroit? Answer: Back in 1930; yes."

"Question: Did you continue your negotiations to the point that you wished to carry them, or did you discontinue them?"

"Answer: Discontinued them, in September, at Mr. Gossler's request."

"Question: Did you do it merely at his request, or what was the consideration that led you to accede to his request?"

"Answer: Well, his talk, at that meeting at the Savoy Plaza, we were going to go along as partners, real part-

ners, and that Detroit would take care of itself very shortly, and to just leave it alone for the time being; gave me—certainly gave me the impression that we were partners.

“Question: Had you made any substantial progress in your negotiations in Detroit, when you discontinued?”

“Answer: Yes. We had that key industry, there. They had stayed with us all through the summer—National Steel Company.

“Question: What do you mean, stayed with you all through the summer?”

“Answer: Well, Mr. Seagraves was busy in Detroit in [fol. 9280] July and August, contracting or making tentative contracts with the various industries in Detroit. The National Steel would use more than any other two.”

I will ask you to identify Mr. Seagraves.

A. That would be quite a job. At that time Seagraves was a partner in a firm down in Texas by the name of Moody Seagraves. That is about all I can tell you about him.

Q. Very well. I shall continue.

Trial Examiner: Banking investment firm of Ed Porters in Galveston?

The Witness: That is right.

By Mr. Littman:

Q. I shall continue.

“Question: Did you negotiate a contract with the National Steel?”

“Answer: Never got a contract form. It was a commitment from the officers of the National Steel to me that if, as, and when we built a line to Detroit, they would give us their business, at a certain price.

“Question: Was that reduced to writing?”

“Answer: It was confirmed by letter; yes, sir.

“Question: Now, come back to this matter that you stated a moment ago, to the effect that the first division

of opinion manifesting itself in the Board of Directors of the Panhandle was over territory. How soon did that [fol. 9281] question arise after you went on the board?

Answer: Either the first or second meeting.

Question: What was the position of the Missouri-Kansas directors on that question?

Answer: That there were no territorial arrangements of any kind whatever.

Question: Is that the consistent position taken by the Missouri-Kansas representatives on the Board all the way through?

Answer: The only one they could take. There never was any agreement.

Have I correctly read from your testimony before the Federal Trade Commission?

A. You have.

Q. I call your attention now to the middle of page 340 of the Federal Trade Commission report No. 82:

"I say in my memorandum to Mr. Hillman, of the same date, in reply to this: 'What he did not tell you was that the gas he refers to, i. e.,—"

A. Wait a minute. You say page 340?

Q. Yes. Just below the center of the page.

A. I have got a question in my mind here: "What statement did you make in your memorandum of April 29 to Hillman—"

Q. Very well. We can go back there if you wish.

A. No, I don't want to go back. We will go ahead. [fol. 9282] Q. We will start with the question, then.

Question: What statement did you make in your memorandum of April 29, to Mr. Hillman, with regard to paragraphs numbered 12 and 13, in his memorandum?

Answer: Mr. Hillman states, in his memorandum:

"I outlined to them—"

"that would be Mr. Gossler and Mr. Munroe—"

—that the additional supply of cheap gas in Kentucky ought to be taken care of, that they could divert their other gas east, and the towns in Indiana and in southern Michigan ought to be developed in time to be big enough to take all of the Texas gas, as well as the Kentucky gas. He reiterated the enormous amount—

—that would be Mr. Gossler reiterated the enormous amount—

—of reserve gas lines they had, and indicated that there was no room for the Kentucky gas, and that, with the amount of gas developed, anybody could go down and gather up a million acres of gas lands and leases.

“I say, in my memorandum to Mr. Hillman, of the same date, in reply to this:

“What he did not tell you was that the gas he refers to, i. e. eastern Kentucky, West Virginia, and so forth, costs from 12 to 15 cents per thousand cubic feet at the well, and that Texas gas and western Kentucky gas can be delivered to Indiana consuming points at far less cost [fol. 9283] than eastern gas.”

“Question: Does that cover both those paragraphs?”

“Answer: No, sir. In paragraph 13, in Mr. Hillman's memorandum, Mr. Gossler reiterates to Mr. Hillman that he wants him, Mr. Hillman, to know all about the difficulties of the Panhandle project, but that he wants to help bring about the success of the Panhandle line. He went over the history of their development and connection with contracts, in the purchase of Panhandle-Eastern line, and how it was put in, not only merely as to its supply of additional gas, but largely to eliminate competition.

“Question: What did you say to Mr. Hillman?”

“Answer: Here, that the very fellow that they had bought half a line from, was starting in when they needed all the customers they had, and was starting to take the trade away from them.

“Question: That is from the Hillman memorandum?”

“Answer: Yes, sir. Now, my memorandum:

The reason that they invested in the Panhandle-Eastern system was to protect their rear. Messrs. Gossler, Gregory, Pew, and F. W. Crawford have all admitted to me that Panhandle Gas, at actual cost, could be delivered at the Indiana-Ohio State line for a less cost, if the line is working at capacity, per 1,000 cubic feet, than West Virginia, eastern Kentucky can be put into the line at the well."

[fol. 9284] Will you please identify for the purposes of this record the Mr. Hillman referred to?

A. Mr. Hillman, at that time was Chairman of the Board of the Peoples Pittsburgh Trust Company, also president of the Hillman Coal and Coke, and various other enterprises in Pittsburgh.

Q. When you made this statement: "The reason that they invested in the Panhandle-Eastern system was to protect their rear," to whom do you refer by "they"?

The Witness: Will you read that?

(The pending question, as above recorded, was read by the reporter.)

A. Columbia Gas and Electric Corporation.

By Mr. Liffman:

Q. Now I have one last—I want you to bear with me on this because it is the last one, but it is the longest of the items I am going to quote. A. All right.

Q. Commencing at page 342 about one fourth of the way down.

By Mr. Wooden:

Question: In this exhibit, you describe your conversation that you had with Mr. C. A. Munroe and Mr. Stanley Russell. Will you give us, briefly, the substance of that conversation?

[fol. 9285] Answer: First, Mr. Munroe opened the conversation by saying that he was deeply concerned over the — had been deeply concerned over the affairs of the Panhandle-Eastern for some time; had now completed his investigation, and, while he could not verify the attached memorandum—he showed it to us at that time, but it, in his opinion, would represent what could be ex-

pected from the operations of the Panhandle Company for the year 1932. Russell laughed at Mr. Munroe's memorandum. I spoke up, and pointed my finger to an item that I am marking X, on the attached exhibit.

Question: Is that attached?

Answer: I don't see any. No 'X' on this one. But it evidently refers to the amounts of gas Columbia would take during the year 1932. Mr. Munroe made the remark, "Unless the Columbia Company takes gas in large quantities during the coming winter, the line is sunk." Said the Columbia Company was opposed to taking gas from Panhandle Company in large quantities, because they had so much of their own.

Question: Let me interrupt you there, and divert your attention momentarily from the memorandum. As a participant in the negotiations, under which the bonds were floated with the National City Company and the September 17 contract was consummated, calling for 30,000,000 feet to Columbia—

Answer: Firm contract for 30,000,000 feet.

164,92864. Question: Do you know why that amount of gas was included in the contract, that 30,000,000 feet?

Answer: Yes, sir. Originally—well, two reasons: first, all through the negotiations with Columbia they had demanded 30,000,000 feet at the terminus of the line at Indianapolis. Then, the original bond issue was to be \$30,000,000. Six percent on that is \$1,800,000 a year.

Question: \$30,000,000? Answer: Yes, sir.

Question: Turned out to be \$20,000,000?

Answer: Yes, sir. That is another story, by itself. The 30,000,000 feet, on the 70-percent load factor would service those bonds and the sinking fund.

Question: In other words, that is how the 30,000,000 feet was arrived at? Answer: Yes, sir.

Question: For the purpose of servicing the bonds?

Answer: Yes, sir; and they wanted the gas, besides.

Question: Now, what is that Mr. Munroe was saying here, in November, 1931?

Answer: That they had more gas than they could handle of their own.

Question: And as I recall it, unless they took their gas—

Answer: Unless they took the gas, the line would be [fol. 9287] sunk.

Question: Tell us a little more about this proposition, that the bond issue originally was to be \$30,000,000 instead of \$20,000,000, as it turned out to be?

Answer: That was at the September 15 meeting.

Mr. Maguire, you now are referring to September 15, 1930? A. That is right.

Q. I read on.

Mr. Gessler had given his little talk about why things had been as they had been; we could now go ahead and finance; mentioned that Mr. Russell had agreed to underwrite thirty to thirty-five million; that he could see where the thing could be a success. He mentioned that they would have the eastern line, this Philadelphia line, about finished by the time the Panhandle-Eastern was—

A. Now, if I may interrupt, "their eastern line" it should be, not "the eastern line."

Q. "Their eastern line," I am sorry. I will read the sentence again.

He mentioned that they would have their eastern line, this Philadelphia line, about finished by the time the Panhandle-Eastern was; that through their connections with the United Corporation they would have the Philadelphia load by the time it was completed; that very large [fol. 9288] quantities of Panhandle gas could be taken and he was not very fearful about the charges. That would be about, oh, 9 o'clock. Along about 11 o'clock that evening, Mr. Gregory and Mr. Munroe said that they were receiving very favorable reports from Mr. Leonard, who was their man in the field from their engineers, and that the line was not going to cost anything like we thought

it was going to cost; that they could probably finish it for \$30,000,000, instead of the estimate that we had always gone on, of 40 to 45. I saw what was coming. I said I thought that was ridiculous, that was too big a difference; what did they have in mind? Mr. Gregory said that he thought \$15,000,000 was enough of the senior issue on this line. Mr. Munroe agreed, and I turned to Russell. I asked him what he thought of it. He said, 'Well, you know what it means.' I said, 'Sure, I do.' Well, what was the Missouri-Kansas to get? Is this off the record?

"Question: I wanted you to develop that. You talked in rather cryptic language; then, about you and Mr. Russell, was it? Answer: Yes, sir.

"Question: Saying, 'You knew what it means.' I want the record to show what it meant.

"Answer: Well, it would require, if the line cost \$40,000,000, and there was only a \$15,000,000 bond issue out, that Missouri-Kansas to furnish their half of that difference, [fol. 9289] would have to dig about \$10,000,000.

"Question: That did not seem at all probable?

"Answer: No, sir; not with the troubles we had just had.

"Question: All right.

"Answer: Russell said—of course, he spoke up. I hoped that the line would be built as cheaply as Mr. Gregory and Mr. Munroe thought it would be, but he was a banker; he was there to serve. If \$15,000,000 was all, that was all right with him, or if \$30,000,000 was what they wanted, that was all right. Mr. Parish thought that maybe they might be right. I said, 'Maybe they may be wrong,' so we fussed around for 30 or 45 minutes more, and finally Parish agreed—I got down to \$25,000,000, as the absolute minimum, but I was just retained as a lawyer would be; I was not running the outfit, but Parish had agreed to \$20,000,000, and I said, 'Where are you going to get the rest?' 'Well,' he said, 'Russell will put it up.' Well, Russell was present, and Russell did not say 'Yes,' and he did not say, 'No.' They arrived at the rather ingenious way of \$10 stock, in stock, and \$90 in notes, for the notes. The

additional money, if needed, was to be furnished in the form of debentures. Along about 1:30, I kind of missed Parish. We had a string of rooms, four or five rooms, and I went looking for him, and I found him in the bath-
[fol. 9290] room, around the corner, with Mr. Gossler. Gossler was trying to buy these bonds direct from Parish.

“Question: When you say ‘he was trying,’ what did you hear? What was said?”

“Answer: Why, Mr. Parish said to me, ‘Mr. Gossler has offered me 92½ for these \$20,000,000 of bonds.’ I turned to Gossler, and I said, ‘Is that right?’ He said it was, and it would save Missouri-Kansas 21½ points, because they were selling it to the City Company, or save the Panhandle Eastern 21½ points, because they were selling it to the City Company for 90. I said in Gossler’s presence, to Parish, ‘It would be the most expensive 21½ points he ever saved,’ and to come with me, and go down to the Vanderbilt Hotel. I took him down to the Vanderbilt Hotel with me, did not give him time to get his hat or his overcoat, and kept him there.

“Question: And, although the Columbia did not buy the bonds direct, they bought them, several days later, from the National City Company?”

“Answer: I learned that, however, as far as my own knowledge is concerned, about the first of December.

“Question: Did you understand, during the negotiations, that the bonds were to be publicly offered and sold?”

“Answer: Yes, sir. I even helped prepare a circular.”

I shall read on, and I believe the testimony from here
[fol. 9291] on is particularly apropos to the situation at hand.

“Question: As a director of the Panhandle-Eastern Pipe Line Company, did you have any opinion, at the time you were a director, to the effect that the affairs of the company were being handled in a way that was not for the best interests of the company?”

“Answer: I did have.

Question: Will you specify wherein you thought that was the situation?

Answer: I thought they should sell gas, which they did not do. I thought that the Columbia management of Panhandle Eastern should live up to their contract.

Question: And take gas?

Answer: And take gas. You see, we had an opportunity to sell a big gob of gas to the St. Louis County Gas Company. They even offered to build from St. Louis County up to the line, near Louisiana, build their own line, 62 miles.

Question: Louisiana, Missouri?

Answer: Yes, sir; and pay us 33 cents for it. The Columbia management said no, because that would be interfering with the Mississippi River Fuel Company, of St. Louis.

Question: Where did that come up? Did that come up before the Panhandle board?

Answer: No. It came up in a meeting that I had with Mr. Gossler, late in October, or early in November, [Vol. 9292] 1930. I had told him that the St. Louis County Gas people were in town, that I would like to bring them over. Said he would not stand for it.

Question: Said what?

Answer: Said he would not stand for it.

Question: In other words, they did not care to sell in St. Louis? Answer: That is right.

Question: Were there any other cities and towns [were] Panhandle Eastern might have sold gas, but where they did not?

Answer: Well, there is an industrial load in Kansas City, of some 6,000,000 cubic feet a year; cheap gas, that is true; but they could have had that, any time in the past five years, around 12½ cents; and their line, right south of Kansas City, is a 24-inch line. They cannot take it

beyond, under normal practice. They might as well sell it, and the interesting thing about that is, that they go—that was too cheap a price, was the excuse, one of the excuses—but they go 200 miles farther, and sell the Atlas Cement, at 11 cents.

“Question: What about the Cities of Hutchinson, Wichita, Emporia, and Ottawa, Kansas?”

“Answer: That was discussed in the board meeting.

“Question: In your presence?”

[fol. 9293] “Answer: Yes, sir.

“Question: What was the substance of that discussion? Answer: That was Cities Service territory.

“Question: And? Answer: Should not be considered.

“Question: Was there any record made on the minutes of that discussion?”

“Answer: There was not, that I know of, or can recall.

“Question: Or of that action? Answer: No, sir.

“Question: Can you say at what meeting of the board, or the approximate time, when that did occur?”

“Answer: Either the January or February meeting of 1931.

“Question: Were you familiar with any negotiations on the part of the cities of Fulton and Fayette, Missouri, to take gas from the Panhandle? Answer: I was.

“Question: What do you know about that?”

“Answer: Mr. Munroe was greatly opposed to supplying municipal plants?

“Answer: That is my recollection, yes.

“Question: When you say he was opposed, what do you base the statement on? That is in the form of a conclusion.

[fol. 9294] “Answer: Why, he definitely stated that he was opposed, that if that sort of thing was encouraged, it would spread.

Question: Do you recall correspondence that the Panhandle Eastern received from its vice president and general manager, Mr. Ray, relating to supplying municipal plants? Answer: I do.

Question: Did you see such correspondence, in your capacity as a director of the Panhandle Eastern?

Answer: No.

Question: How did you see it, or become familiar with it?

Answer: Mr. Gregory showed it to me, one day.

Question: After the September, 1930, financing, and the acquisition of the 50 percent stock interest by Columbia in Missouri-Kansas—is that the correct date?

Answer: October. The actual closing was in October.

Question: Was there any change in the method of framing the rate base, in Illinois?

Answer: Yes, it was put on the commodity and demand and service charge basis.

Question: Instead of what? What had it been?

Answer: Just straight, flat sale price.

Question: What effect would you say that change would have upon the consumption of the gas?

[Feb. 9, 1935] Answer: Held it down, and Mr. Barthold, the largest customer of Panhandle Eastern in Illinois, so stated to me, that it was crippling his sales of gas in Peoria.

Question: Do you know anything of an opportunity that the Panhandle Eastern Company had to supply gas to the Midland United System?

Answer: What time are you speaking of?

Question: 1931.

Answer: Well, in '31, that was still under Insull management, and there was an agreement between Columbia and the Midland United Crowd, on that.

"Question: On that, you mean with reference to taking gas from the Panhandle Eastern line?

"Answer: Taking gas from Columbia.

"Question: Were there any negotiations with regard to Midland-United taking gas direct from the Panhandle Eastern? Answer: Not that I know of.

"Question: Did you negotiate a sales contract at Indianapolis? Answer: Folks in my organization did, yes.

"Question: You were in close touch?

"Answer: Oh, yes. I directed it, yes.

"Question: You directed it? Answer: Yes.

"Question: Will you state, just in a general way, what [fol. 9296] was done at Indianapolis, with a view to providing a market?

"Answer: We secured, roughly, some 30-odd contracts, all the larger industrial users, for a period of years, at an average price, I think, on all the contracts, of about 32 or 33 cents. Most of them were executed prior to February. Most of the contracts were executed prior to February, 1931, and we cooperated with the Indianapolis Manufacturers' Gas Association, a group of manufacturers that had been trying to get natural gas for some time and had been unable to. They needed it, and were actively out, trying to get it.

"Question: Have they got it yet?

"Answer: They have not.

"Question: And how close are they to it?

"Answer: About eight miles.

"Question: Did you hear Mr. Parish's testimony with reference to your 'stirring up Indianapolis,' and having it 'put back to sleep, again'? Answer: I did.

"Question: What did you do toward stirring it up?

"Answer: Oh, I got an option from the receivers on the 20,000,000 feet that they are entitled to; tried to get a permit to put it into Indianapolis, in 1933. I was unsuccessful.

ful, but the Indianapolis manufacturers were just as desirous, then, as they were two years previously."

Now, will you please identify the receivers to whom you [fol. 9297] referred?

A. The receivers were the Missouri-Kansas Pipe Line Company.

Q. I shall continue.

"Question: Do you know of any efforts that were made to 'put Indianapolis back to sleep'?

"Answer: No; not directly, no.

"Question: Do you know whether it is a fact, or not, Mr. Magnire, that Panhandle-Eastern today has any other outlets of importance, in addition to the contracts that it took over from Missouri-Kansas, in 1930?

"Answer: They have increased their load very little. I am not directly familiar, but very little.

"Question: Did you ever make any calculations showing what would have been the result if certain markets had been supplied, which could have been supplied? I refer in this connection to your memorandum, and you make some calculations, there, I believe, regarding available markets in certain towns in Kansas, Missouri, and Indiana. Answer: Yes, I made those calculations.

"Question: What was the purport of those calculations that you made? What do you now say about them?

"Answer: Well, I say they are correct. If anything, they are a little low. Yes, sir; those figures are all right. They are on the conservative side. There is a difference [fol. 9298] of \$4,036,500.

"Question: What do you mean by a difference of that much?

"Answer: Well, it is revenue that Panhandle-Eastern could have, right now, that they are not enjoying—if they sold gas.

"Question: And is that based upon estimates of the available business in certain towns? Answer: Yes, sir.

"Question: Will you say what they were?

"Answer: In Kansas, Hutchinson, Wichita, Emporia, and Ottawa. When was this memorandum made?

"Question: I think it is in 1934, if I am not mistaken.

"Answer: At that time, as I recollect it, Hutchinson and Wichita were—there was a municipal campaign on, or something. Anyway, they wanted to buy gas. At Kansas City, the industrial load is far greater than what I show, but the price is much less; and I will see how it works out, if I may take the time. It would work out the gross revenue would be about the same. St. Louis County Gas Company is gone. That is tied up, now, with Mississippi River Fuel.

"Question: Wasn't it then? Answer: No, sir.

"Question: Wasn't that then considered Mississippi [fol. 9290] River Fuel territory?

"Answer: Well, the St. Louis County Gas people did not consider it that way. They are part of the North American Company, and they did not consider it that way at that time.

"Question: But now it is tied up?

"Answer: Now it is tied up. Indiana: Midland-United will take more gas than I show here, and they will pay about that price.

"Question: What price?

"Answer: I show 30 cents here. They will pay about 35 right now. Manufacturers Gas Company, that is all right.

"Question: Is that Indianapolis?

"Answer: Yes, sir; and I call your attention that I figure the Columbia contract on the dump-load base, and not at the firm contract basis, and if it was taken on that basis, the difference would be an additional \$557,000 per annum.

"Question: Was that more than enough to carry all the investment in the company? Answer: Yes, sir.

"Question: With a profit? Answer: Yes, sir."

I will interrupt there to ask you what company are you referring to at that point: Panhandle Eastern Pipe Line [fol. 9300] Company?

A. Must have been.

Q. I shall continue.

"Question: You mentioned some prices, there, 30 cents in Indianapolis? Answer: Yes.

"Question: Was that for industrial?

"Answer: No, not industrial. The industrial load at Indianapolis is figured at $26\frac{1}{2}$. The actual contracts we had averaged about 33. The reason we used $26\frac{1}{2}$, there, was that was Missouri-Kansas' firm contract price at that time.

"Question: What was the domestic rate in Indianapolis at that time?

"Answer: Well, that is artificial gas, and I think their lowest rate was somewhere around 70 cents a thousand, 540 gas.

"Question: As against what B.t.u. content for the Panhandle? Answer: One thousand B.t.u.

"Question: What do you know about the extension of the Panhandle Eastern line to Macon, Missouri, the proposed extension? Was it made?

"Answer: Yes, and I opposed it as the useless expenditure of money. There was not enough—well, I just opposed it. It was not good business.

"Question: Were you the only opponent?

[fol. 9301] "Answer: I think I was. Mr. Bay—I think Mr. Parish backed me up, and said he would like to wait and talk to Mr. Bay. He did. Mr. Bay came over to the office, talked to Mr. Parish, and then Mr. Parish wrote, approving it. I learned about that afterward.

"Question: Was that in connection with the budget which Mr. Parish said was old?

Answer: Well, it took—I have forgotten the amount, but somewhere around \$200,000, depleted the available cash that much. I recall I went over and complained about it to Mr. Munroe, as a director, very seriously, and very strenuously. It was too late.

Question: Had you taken any steps to get business in Detroit before this September, 1930, contract with Columbia? Answer: Yes.

Question: What had you done?

Answer: Just gotten in touch with the National Steel people, got a verbal agreement from them that they would, if a, and when we extended to Detroit, if we did it promptly, that they would buy gas from us at a scale of prices. As I recall, they ran, for various operations, the open hearth were to be on a certain basis, soaking pits on another, slab mills on another; the average price to be somewhere around 29 cents.

[fol. 9302] Question: And that was before September, 1930? Answer: Yes, sir.

Have I read correctly from your testimony before the Federal Trade Commission?

A. I think you have.

[fol. 9303] Q. You have followed my reading of your testimony, have you not? A. I have.

Q. Certain litigation has arisen by reason of claims of Mokon against the Columbia interests, have there not?

A. Yes.

Q. One of those suits was a suit by Mokon for treble damages? A. That is right.

Q. Now, who was the plaintiff in that suit: Mokon?

A. The receivers of Mokon.

Q. And who were the defendants?

A. Columbia Gas and Electric Corporation, Columbia Oil and Gasoline Corporation, P. G. Gossler, George Crawford, Fred Crawford—well, practically all the Columbia board of directors at that time.

Q. What did the receivers of Mokon sue for: what amount?

Mr. Hand: I can't hear you.

Mr. Wheat: May I suggest, Mr. Examiner, that Mr. Richard B. Hand, an attorney who has represented Mr. Maguire and Missouri-Kansas in many matters, is sitting with me, and I should like to associate him with me in this matter. He may be able to assist in answering some questions of this type in connection with Mr. Maguire's testimony.

[fol. 9304] Trial Examiner: That will be entirely agreeable.

Mr. Hand: I couldn't hear what you said [is] all.

Mr. Littman: What relief was prayed for in that suit, just generally, in order to put it on the record.

Mr. Hand: A suit for money damage.

Mr. Littman: What was the amount claimed?

Mr. Hand: My recollection was that we claimed 30 million, was it?

It is all in that prospectus; I have forgotten the amount.

Mr. Wheat: Exhibit 145, I think you will find, has the complete history of that.

By Mr. Littman:

Q. Well, that suit briefly sought damages arising out of the claims made by the receivers of Mopan with respect to the alleged mismanagement of Panhandle Eastern; is that right generally? A. That is correct.

Q. When was that suit filed, approximately?

A. In '35.

Mr. Hand: 1935, yes.

By Mr. Littman:

Q. That suit was settled, was it not? A. It was.

Q. Do you remember about when?

[fol. 9305] A. June 1936.

Q. One of the allegations made in that petition was that the management of Panhandle Eastern had failed or neglected to develop its market during the periods which we have discussed; is that right?

Mr. Wheat: I think that would be the document. Mr. Hand who sits next to me, and who was associated in that case, has stated that he—

Mr. Hand (interposing): I wouldn't like to be too sure of that.

Mr. Littman: I thought we might be relieved of the necessity of putting in a lengthy petition.

Mr. Hand: I will be glad to give you a copy of the bill.

Mr. Littman: I would greatly appreciate it.

Mr. Hand: I will be glad to give it to you.

By Mr. Littman:

Q. At any rate the suit was settled? A. Yes.

Q. Can you briefly state the basis of the settlement and the amounts paid by Columbia?

A. That was brought about by the consent decree, and we are still suing about that.

What was supposed to be an initial one-half interest in Panhandle Eastern was to be returned to us.

[fol. 9306] We maintain that that was not done. They agreed to pay, among other things, \$300,000 in cash for receivership expenses. We have never seen the "among other things" and we are still at it.

Mr. Wheat: When you spoke of a consent decree, did you refer to some litigation against Columbia Gas and Electric Company in the federal courts?

The Witness: That is right. I think it is No. 1099.

Mr. Wheat: May I ask him a question in that connection, Mr. Littman?

Mr. Littman: Go right ahead.

Mr. Wheat: Who was it that you said—in the testimony that Mr. Littman has read—some company of Detroit with which you had had a verbal agreement?

The Witness: National Steel Company.

Mr. Wheat: National Steel Company?

The Witness: Yes.

Mr. Wheat: That is an industry located in Detroit, is that right?

The Witness: No. It is out of Detroit.

Mr. Wheat: It is close to Detroit?

The Witness: It is in the Detroit area, yes.

Mr. Wheat: Can you state, at that time, whether any contract, verbal or otherwise, was entered into with the Detroit City Gas Company?

[fol. 9307] The Witness: Yes. I talked to Mr. Eaton. Mr. Chamberlain can refresh my mind on that. I don't know whether Mr. Eaton was still Chairman in 1929 or not, but he was still acting.

Mr. William Chamberlain was president of the United Light and Power, United Light and Railways at that time. I think Mr. Brown—Yes. R. R. Brown was over at Detroit. I talked to Mr. William Chamberlain in April of 1930 about Detroit.

Trial Examiner: The Trial Examiner is commencing to be a bit disturbed about the possibility that we are unnecessarily enlarging the scope of our inquiries.

Just how much of this matter is actually relevant to the alleged unused capacity, and the claim variously denominated resulting from that alleged unused capacity? Just how far should we go afield, particularly in view of the expressions recently of the Supreme Court of the United States.

Mr. Littman: I have completed my reading from the Federal Trade Commission reports, and I merely have a few more brief questions to ask of this witness, and I will then have completed my examination.

Mr. Wheat: In connection with the Examiner's remark, I want to say that we also had some worry with respect to the scope of this inquiry.

[fol. 9308] The fact of the unused capacity has nowhere been questioned in this direct, and the fact

Mr. Littman: I certainly can't agree with that.

Mr. Wheat: I repeat that. The fact that there was unused capacity, there was a pipe line which was not used, has nowhere been questioned by anyone at any stage of this proceeding.

Mr. Lee: Yes, but the reasons for that—

Mr. Wheat (interposing): I don't care what the reasons are. I just made a statement of fact. Somebody said he questioned it, and I repeated it.

Now, there is also one other thing: the fact of the history of this company differing from that dealt with in the decision of the Supreme Court, mentioned by your Honor, is also unquestioned in this record, and I thought I ought to say, in connection with my preliminary statement, that I very thoroughly agreed with the Examiner in his thought that possibly we were getting fairly far afield.

Trial Examiner: The Supreme Court called attention to the fact that the facilities in question had been included in the rate base.

Mr. Wheat: Yes.

Mr. Littman: I take it your Honor is accusing me, perhaps, of being a bit too thorough in this matter?

Trial Examiner: Not in the least, Mr. Littman, but [fol. 9309] reminding us all that we must sometime get through.

Mr. Littman: Very well. As I say, I have completed reading from the transcript of the testimony in the Federal Trade report.

I merely have one further question to ask, in that connection.

Trial Examiner: Proceed.

Mr. Wheat: When the question arose, Mr. Maguire was answering a question [which] I admit I had placed in this record out of place, but with the agreement of counsel, and he hadn't quite finished his answer.

Possibly I can shorten the time by asking Mr. Maguire this brief question:

Was any contract made with the Detroit City Gas Company at that time?

The Witness: There was not.

Mr. Wheat: Thank you. That is all.

By Mr. Litman:

Q. Mr. Maguire, when you testified before the Federal Trade Commission, giving the testimony which I have just read this afternoon, who was present at those sessions? I have in hand any representatives of Columbia interests.

A. Well, on one of the days, I am very—I can recollect very clearly that Mr. Moffat was there, and Mr. Harold [fol. 9310] Ritz.

There is another Columbia attorney whose name I can't recall, and then some Cities Service people were there. Judge Burns.

The Standard, Mr. Doherty—an attorney for the Standard—and Mr. Christy Payne, vice president of the Standard.

Q. Were there counsel present?

A. Mr. Doherty and Mr. Hall.

Q. Were you cross-examined by any of those gentlemen? A. I was not.

Q. Do you recall whether the Trial Examiner at that hearing afforded them the opportunity to cross-examine you? A. He did.

Q. But they did not cross-examine you?

A. They did not.

Q. Mr. Maguire, I merely want to very briefly interrogate you about another matter:

There have been offered in evidence in this proceeding, as a part of Exhibit No. 87, copy of a contract between the Panhandle Eastern and Missouri Power and Light Company, dated May 19, 1930, and a contract between Panhandle Eastern Pipe Line Company—

A. (Interposing) May 1930?

Q. Yes. Dated May 1930. (continuing)—and a contract—

[fol. 9311] Trial Examiner (interposing): You are now showing Mr. Maguire part of Exhibit No.—what is it?

Mr. Littman: 187.

Trial Examiner (continuing)—187?

Mr. Littman: Yes, sir.

By Mr. Littman:

Q. Suppose you look at the contract to which I have just referred, and see if you recall that contract.

A. Yes. I made it.

Q. You say you made the contract?

A. Well, my organization did, yes.

Q. Did you negotiate that contract?

A. If it is the one I think it is I did, yes. I can answer this: I know that this contract was negotiated by me but-so far as ever seeing the contract as such before: no. The thing that comes to my mind is the 40-cent base, and the reduction in price; and 16-cents plus a half—all that.

Q. In other words it is your best recollection at present? A. Yes.

Q. That you did, in fact, negotiate that contract between Panhandle Eastern Pipe Line Company and Missouri Power and Light?

A. Yes. That is, North American Light and Power, yes.

Q. That is, that company was a subsidiary of North [fol. 9312] American Light and Power? A. Yes.

Q. Did you also negotiate a contract between Panhandle Eastern Pipe Line Company and Illinois Power and Light Corporation? A. Yes.

Q. Which is the second contract which is a part of Exhibit 187? A. And it is the same company.

Q. That is the same holding company?

A. The same holding company.

Q. Now, who if anyone else assisted in the negotiation of those contracts?

A. Maguire and—an outfit called Maguire and Company did this job.

Now, what contracts are you referring to?

Q. I am talking about the two contracts.

A. Just the two: the Missouri Power and Light and the Illinois Power and Light?

Q. That is right. A. Well, that is all.

Q. No one else took part in the securing of the business; that is the part I am talking about.

A. I know no one else did.

Q. Now, what arrangement did you have with Panhandle Eastern for compensation for your services rendered in connection with the securing of the business comprehended by those two contracts?

A. I got paid for it, got 7,000 shares of stock—Maguire and Company got 7,000 shares of Missouri-Kansas Pipe Line Company stock.

Q. 7,000 shares?

A. That is right, and we got some of them here, but we got them at 33 or 34 or 35 dollars a share.

Q. Now, you have referred to Maguire and Company. Was that your company?

A. I was the largest stockholder, but it wasn't mine entirely, no.

Q. I see. You were the president of that company?

A. I was.

Q. Now, you received 7,000 shares of Missouri-Kansas stock? A. That is right.

Q. And who gave you those 7,000 shares for the services which you performed in connection with those two contracts? A. Frank P. Parish.

Q. In his capacity as president of the Panhandle Eastern Pipe Line Company? A. Yes, sir.

[fol. 9344] Q. And when did that occur?

A. I just don't recall. I should say offhand sometime early in June. I can look it up for you.

Q. Early in June 1930? A. 1930, yes.

Q. Did Mr. Parish render any services in connection with the securing of those two contracts?

A. Well, now, you are asking me for a conclusion. I can only say; not that I am aware of.

Q. Not that you are aware of? A. That is right.

Q. Do you know whether a Mr. Innis rendered any services in connection with the procuring of these contracts, Mr. Maguire? A. None whatever.

Q. Is the same true of Mr. Parish? A. Well—

Q. Or don't you know?

A. I would like to explain my answer.

As far as any real service, no, but Parish was president of Panhandle Eastern.

What he would contribute as president of Panhandle Eastern and as president of Mokon I don't know, but as far as I am not aware of his performing any service other than signing these contracts, even if he did that.

[Col. 9315] Mr. Wheat: You are speaking, Mr. Littman, are you, of these two contracts?

Mr. Littman: Yes, sir.

The Witness: Yes.

By Mr. Littman:

Q. In other words you feel that it was your services and your services alone that were responsible for the securing of the business comprehended by these two contracts and the two contracts?

Mr. Wheat: Mr. Examiner, before the witness answers I think I am going to have to object to a question as to what the witness feels.

I am sure it is immaterial to this Commission whether he feels this or feels that.

What he knows, if it is pertinent, is a proper inquiry.

Mr. Littman: All right, I will change the word "feels" to "know" and ask that the question be restated in that way.

Mr. Examiner: Read the question.

(Whereupon the pending question was read by the reporter as follows:

("In other words you know that it was your services and your services alone that were responsible for the securing of the business comprehended by these two contracts and the two contracts?")

A. Well, it is a self-serving statement, but I certainly do.

[Vol. 9316] May I make this suggestion: if you will read Mr. L. E. Fisher's testimony in this same hearing—
 identical. See what he says about it.

By Mr. Littman:

Q. Very well.

A. I might say this: when these contracts were being negotiated Mr. Innis was up in Omaha, Nebraska. That is quite a ways from Chicago.

Q. Do you know that Panhandle Eastern Pipe Line Company purchased 19,000 shares of Mokon stock, common stock, purportedly for the purpose of making payment through the medium of Mr. Parish as president of Panhandle Eastern for services rendered in connection with the procuring of these two contracts: do you know that?

A. I know it now, but I didn't know it at the time.

Q. You later discovered that 19,000 shares of stock were distributed in payment for those services?

A. I found out about that in 1935.

Q. That was about five years after—

A. (Interposing) That is right.

Q. (continuing)—after the contracts—

A. (Interposing) I knew sometime in '32 that that had been taken out, but I never knew that I was supposed to have gotten it, or Maguire and Company was supposed to [Vol. 9317] have gotten it until April of 1935.

Q. And what if anything did you do about the situation when you first learned that you were supposed to have received these 19,000 shares of Mokon stock?

A. Well, by that time, relationship wasn't friendly and—
 Are you referring to the correspondence that I sent Panhandle Eastern on the subject in 1937?

Q. Yes.

A. Well, it speaks for itself.

Q. Do you have a copy of that correspondence here?

A. No.

Q. We have the reference to the correspondence that was made in the minutes, but we don't have the copy of your letter, because it was not in Kansas at the time we first requested it.

I wondered whether you happened to recall the substance of it.

Suppose you state the substance of it: that ought to be sufficient.

A. I thought that the difference between the 7,000 and the 19,000 should be returned.

Q. To you?

A. No, to Panhandle Eastern Pipe Line Company.

Q. To Panhandle Eastern Pipe Line Company?

A. Yes.

[fol. 9318] Q. Why?

A. Well, all Maguire and Company got was 7,000 shares.

Q. It was supposed to have gotten the whole 19,000 shares?

A. That is correct.

Q. What happened to the other 9,000?

A. You are asking me for a conclusion. I have never yet been able to find out.

Cross Examination

By Mr. Chamberlain:

Q. I have about three questions here.

Mr. Maguire, would you refer to Page 402 and 403 of Volume 82?

A. All right.

Q. I ask you to do that merely to refresh your recollection if you need to—and I doubt if you do—with respect to your negotiations for a contract for certain industrial gas in Kansas City in 1932. Can you tell us something about that?

A. I think that was 33, Mr. Chamberlain.

Why, we got together—let's see—we had Swift and Company, Armour and Company, Wilson—can you give me some other names?

We had nearly every packer in that district—Swift, Armour—Cudahy is another—Wilson—a tentative arrangement with the municipally-owned electric generating station in Kansas City, Kansas, and a tentative arrange-

ment with the Kansas City Power and Light—Mr. Porter to sell him boiler gas.

As I recollect it the industrial load was somewhere around between 13 $\frac{1}{2}$ to 15 cents, something like that, and with Mr. Porter—the Kansas City Power and Light—I think it was on a fuel basis; that is, on a R.t.u. basis—and my recollection does not serve me exactly—I think it worked out about 13 $\frac{1}{2}$ or 14 cents.

Q. This says 13 or 13 $\frac{1}{2}$.

A. Yes.

Q. Now, what is the fact with respect to whether you were able to get that contract accepted by Panhandle Eastern—or those contracts?

[fol. 9320] A. They said No.

Q. You negotiated what is known, and has been described here, as a contract of September 17, 1930, between Missouri-Kansas Pipe Line Company, the National City Company, and Columbia Oil and Gasoline Corporation, did you not?

A. Yes, sir.

Q. I ask you to look at Page 4251 of Volume—No, I am sorry; it is Volume 66—Volume 66 of the Federal Trade Commission reports, and to state whether that contains a copy of that contract.

Now, personally I was interested in two parts of that. It is possible that counsel will want the whole document in evidence and if so I will be glad to offer the entire contract.

Mr. Littman: I think the entire contract, to which numerous references have been made, should be made a part of the record.

Frankly, I had looked for it in those Federal Trade Commission reports, and I was unable to find it. I am glad you found it, and I would like very much to have it made a part of this record.

[fol. 9321] Mr. Littman: There was also an amendment, was there not, Mr. Chamberlain, to that contract, in the

month of October 1930, that should properly be made a part of the record also?

The Witness: I would like to say I learned about that amendment, however, as far as any question to me, I learned about that amendment in 1937, when we got the Missouri-Kansas books back.

Mr. Culton: Mr. Examiner, may I suggest that this contract, with supplements, apparently 10 or 12 pages long, very fine print—and while we have a very high regard [fol. 9322] for the Electreporter people, we doubt the wisdom of requiring us to pay for that many sheets of paper in the transcript.

If Mr. Chamberlain considers that of importance, I see no reason why he could not produce it as an exhibit and let it go in as an exhibit.

Mr. Chamberlain: I was going to suggest that it be offered as evidence here, with the permission to substitute a written copy of it, under some given number, and I will be glad to do that. It is a long statement.

Trial Examiner: Will you do that, Mr. Chamberlain?

Mr. Wheat: It would be about thirty pages in the transcript, or more.

Trial Examiner: When you have presented that it will be received, I assume, without objection by counsel.

Mr. Chamberlain: All right. Intervenor offers in evidence a copy of the contract of September 17, 1930, between Missouri-Kansas Pipe Line Company, party of the first part, the National City Company, party of the second part, and Columbia Oil and Gasoline Corporation, party of the third part, which is contained in and forms a part of Exhibit No. 6005 of the Federal Trade Commission reports, and is contained in Volume 66 on Page 1251 and the pages following.

[fol. 9324] Q. • Mr. Maguire, were you present at a meeting of the board of directors of Panhandle Eastern Pipe Line Company held at 61 Broadway, New York, at three o'clock p. m. on Tuesday May 26, 1931?

A. I was.

Q. And were there present the following directors: F. W. Crawford, F. V. Dupont, T. B. Gregory, G. H. Howard, W. G. Maguire, O. A. Munroe, F. P. Parish, and S. A. Russell?

A. Yes.

Q. At that meeting did you hear F. W. Crawford, who was then president of the Panhandle Eastern Pipe Line Company, and an officer and director of Columbia Gas and Electric Corporation, make the following statement:

"The Panhandle Eastern Pipe Line Company has made, [fol. 9325] or has under consideration, various contracts for the sale of gas to other companies, each for their requirements in certain specified communities and territories."

"Among such proposed gas sales contracts are those under which Columbia Gas and Electric Corporation and Missouri Kansas Pipe Line Company would be entitled to call on the Panhandle Eastern Pipe Line Company to supply them with gas. It was definitely agreed that any gas to be taken under such contract by Columbia Gas and Electric Corporation would be for supplying Indianapolis and northern Indiana territory, extending to Detroit and other points in Michigan and connecting with existing pipe lines in Ohio."

"It was likewise definitely agreed that any gas to be taken under such contract by the Missouri Kansas Pipe Line Company would be only for the purpose of supplying gas to the southwestern part of Indiana through Terre Haute and south to Nashville, Tennessee."

"The Panhandle Eastern Pipe Line Company hereby notifies both Columbia Gas and Electric Corporation and Missouri-Kansas Pipe Line Company that it does not consider that either of them would be entitled to gas under such contract if the gas so supplied is to be used in violation of the above agreements, or for the purpose of interfering with distribution of gas by the other party."

Mr. Wheat: Now, Mr. Chamberlain, may I ask: did you [fol. 9326] ask the witness to state whether he recalled that some person made this statement?

Mr. Chamberlain: That is right.

Mr. Wheat: In those words?

Mr. Chamberlain: That is right; whether Fred W. Crawford, president of Panhandle Eastern made that statement at that meeting, in the presence of Mr. Maguire.

A. He most certainly did. That is the basis—what Mr. Chamberlain is talking about is why we are here today.

Q. Now, at that time, and in your presence, did Mr. Charles A. Munroe state that he did not see any particular objections to the adoption of the resolutions or the making of the contracts with Missouri-Kansas and Columbia Gas and Electric, contemplated by them, but he wanted it distinctly understood that those contracts should definitely provide that none of the gas taken by Missouri-Kansas should be supplied in the Indianapolis market, because that would be a violation of the agreement to take such gas for the purpose of supplying southern and southwestern Indiana and southward, including Nashville, Tennessee?

A. Do I recollect that?

Q. Yes.

A. Very vividly.

Q. And following that, did Mr. Gregory, also a director [Vol. 9327] of Panhandle Eastern, suggest that that statement of Mr. Munroe's be amended, or supplemented by the statement that the Panhandle would sell gas to Columbia Oil and Gasoline Corporation for distribution in the Indianapolis market, because that was in accordance with the agreements on which such contracts would be based?

A. He did.

May I suggest that there is a lot more in that, that is interesting, there?

The Missouri-Kansas people—that is one of the really choice meetings that we had, and we all stated that there was no such agreement, and no such agreement had ever been made.

That is a little farther along there.

Mr. Wheat: You took part in that meeting yourself, in that connection, didn't you, Mr. Maguire?

The Witness: Yes, I think you can get testimony on that subject, that I took part in that.

Mr. Chamberlain: And at the meeting you expressly denied that there had been any such agreement to allocate territory?

A. That is correct.

So did Mr. Dupont. So did Mr. Parish. So did Mr. Russell.

[fol. 9328] Mr. Littman: I don't know whether other counsel desire to interrogate Mr. Maguire. I have no further questions.

Mr. Wheat: We have no questions.

[fol. 9329]

LEITH V. WATKINS, was recalled as a witness, having been previously sworn, was further examined, and testified as follows:

Cross Examination

By Mr. Chamberlain:

Q. Mr. Watkins, do you recall a provision of the gas contract between Panhandle Eastern Pipe Line Company and Detroit City Gas Company, dated October 31, 1935, with respect to the time of payment and the place of payment?

A. I recall that there is such a provision, yes.

[fol. 9330] Q. And in that contract did the Detroit City Gas Company, as buyer, agree to pay Panhandle Eastern, at its designated office, on or before the 20th day of each calendar month, for natural gas delivered during the preceding months; according to the measurements, computations, and prices herein provided, and billed by seller in a statement for said month?

A. Yes. There is such a provision in Subdivision 1 of Article 9 of that contract.

Mr. Chamberlain: I would like to have that identified as an exhibit.

(The document referred to was marked for identification as Exhibit No. 209.)

[fol. 9331] The letter, of which you have now handed me a carbon copy, will be marked for identification as Exhibit 209.

Q. Did you, Mr. Watkins, as secretary of Panhandle Eastern, direct a letter to the Detroit City Gas Company on March 30, 1936, in which you designated the office to which they should make payment for gas under the contract which I have just described?

A. That is correct, but the letter provides that this plan would be agreeable to the Detroit City Gas Company, and the copy which counsel has just handed the witness carries such an endorsement signed by the president of that company.

May I have a copy of that?

Q. Yes (handing). A. Thank you, sir.

Q. That was not at the request of the Detroit City Gas Company, was it? A. The letter itself?

Q. Yes. A. Oh, no.

Q. It was directed by you to them? A. That is correct.

Q. And is that you designated where they should make the payments? A. Subject to their acceptance.

[fol. 9332] Q. Yes. A. And they did accept it.

Q. They accepted it? A. Yes.

Mr. Chamberlain: The intervenor offers in evidence the exhibit No. 209.

(The document referred to was received in evidence as Exhibit No. 209.)

[fol. 9349] DAVID FRIDAY a witness, having been previously sworn, resumed the stand and testified further as follows:

[fol. 9350] Direct Examination (Resumed)

By Mr. Culton:

Q. Dr. Friday, you testified in these proceedings six months ago, did you not?

A. Yes, on October 3, I believe it was.

Q. And since that time we have had a war situation exist in this country. I will ask you to state whether or not you have continued the studies which you presented six months ago so as to reflect the present conditions existing?

A. I have.

Q. Have you pursued your studies largely along the same lines as the studies reflected in your former testimony?

A. Yes. What I have done is to bring especially the statistical series there on down to date.

[fol. 9351] Q. Dr. Friday, on Page 4 of Exhibit 61 presented in connection with your former testimony, you incorporated index numbers of wholesale prices of commodities, by groups, using 1926 as 100. What have you done toward bringing that table to date?

A. I have added to that table the index numbers, by groups, for March 21, 1942, which is the last date for which they are available.

Q. Will you explain what is shown by that table with respect to changes since your former testimony was given?

A. This table shows the prices, by groups, at the time my former testimony was given, September 30, 1941, were the last prices we had at that time and the present prices which, by the way, are shown on a second sheet which we have here as issued by the Bureau of Labor Statistics, those prices have now risen to 97.2. The prices stood at 91.5 for all the 900 commodities in September and, on March 21, they stood at 97.2. They had, therefore, risen 5.7 per cent which is a little over 6 per cent. Every group has risen excepting only the group of fuel and lighting. That has fallen a little bit.

Q. Is that reflected in the document which has been passed to counsel giving index numbers of wholesale prices?

A. It is.

[fol. 9352] (The document referred to was marked Exhibit No. 210 for identification.)

Mr. Culton: Mr. Examiner, during the short delay, I have passed around a number of documents and I suggest that the record might now show that they have been given certain exhibit numbers.

I therefore ask that document styled, "Index Numbers of Wholesale Prices of Commodities by Groups" be marked Exhibit No. 210;

A letter or circular from the Bureau of Labor Statistics captioned, "Wholesale Prices for Week Ended March 21, 1942" be marked Exhibit No. 211;

A table showing, "Index Numbers of Wholesale Prices [fol. 9353] of All Commodities by Months" be marked Exhibit 212;

A table showing, "Average Hourly Earnings and Average Actual Hours Per Week Per Wage Earner in 25 Manufacturing Industries" be marked Exhibit No. 213;

A graph captioned, "Average Hourly Earnings and Average Actual Hours Per Week Per Worker in 25 Manufacturing Industries" be marked Exhibit No. 214;

A copy of a table captioned, "Employment, Payrolls and Average Weekly Earnings in Representative New York State Factories" be marked Exhibit No. 215;

A table showing, "Indexes of Wholesale Prices and Cost of Living for Certain Months, 1913 to 1942" be marked Exhibit No. 216; and,

A graph from the Bureau of Labor Statistics, source Bureau of Labor Statistics, and reflecting "Cost of Living, 1935 to 1939 as 100," and I ask that be marked Exhibit No. 217.

(The documents referred to were marked Exhibits Nos. 211 to 217, both inclusive, for identification.)

By Mr. Culton:

Q. Dr. Friday, you have explained Exhibit 210 and I believe had started to discuss Exhibit 211, had you not?

A. I was explaining Exhibit 210, I believe. What I said about it was that the general index of prices had advanced [fol. 9354] vanced from 91.5 to 97.2 which is a little over 6 per cent advance and that in every group, the prices set forth below, except the fuel and lighting group, had advanced from September 20 to March 21. That group has declined 1.8 but it is still higher than it was in August, 1939, but it is not higher than it was on September 20.

Q. Why did you use the date March 21, 1942?

A. I used that date because that was the last date available. Those are the figures given out one week ago today, that is, this evening. They give them out at five o'clock at night and it happens to fall exactly six months from September 20, 1941.

Q. Will you please explain Exhibit No. 211?

A. Exhibit 211 I simply introduce because it was the source of the data on Exhibit 210 for the additional date of March 21.

Q. I believe a similar letter was offered as a part of your former testimony?

As A-2?

A. It was, yes sir.

Q. Will you explain Exhibit 212?

A. Exhibit 212 is introduced here primarily because a similar release of the Bureau of Labor Statistics was offered in my previous testimony and this brings it down [fol. 9355] to date as far as it does exist now. I might say in passing that the prices there, these are for whole months, have risen from an average of 91.8 in September to an average of 96.7 in February. Those figures are not yet available for March.

Q. And that would be what percentage of increase, Dr. Friday, roughly?

A. That would be a percentage increase of a little less than 6 per cent.

Q. You had a similar exhibit to that, I believe, in connection with your former testimony brought down through July, 1941?

A. That is correct.

Q. Will you now explain Exhibit No. 213?

A. Exhibit No. 213 sets forth the average hourly earnings of 25 manufacturing industries as compiled by the National Industrial Council Board. My previous exhibit had a graph showing those figures. It is my recollection we did not actually put them in. Here they are for the convenience of the Court and everyone else.

I put them in completely from July, 1914, to January, 1942, which is the last date for which they are available and that shows that, since last September when the latest figures were available, the average hourly earnings in these manufacturing establishments had risen from 82.2 cents to 88.2 cents, a little over 7 per cent.

[fol. 9356] Q. I believe you had a chart presented with your former testimony, Document C, attached to that testimony?

A. Yes, sir.

Q. This table down to July, 1941, supports that chart, is that correct?

A. That is correct, sir.

Q. Have you also prepared a chart giving that information down to date?

A. I have and that is Exhibit 214. I may say to those who have the previous charts before them, the graphs are in a somewhat different position on the chart. They are lowered and somewhat smaller. The prices had risen so fast they practically ran off Chart C so I lowered the chart and smallled it somewhat so as to get the chart on now.

Q. Dr. Friday, the trend of average hourly earnings and average actual hours per week per worker in these industries has risen steadily since your former testimony, is that correct? A. That is correct.

Q. How about the steepness of the curve?

A. That has continued without abatement. It has not abated at all. The last page of the exhibit, No. 213, shows exactly what has happened during the last year. One year

ago the average hourly earnings were 75.9 cents and at January of this year they were 88.2 cents which is an advance of 12.3 cents in the year.

Q. Has there also been an increase in the hours of work per worker during that same period?

A. Yes, the hours of work have increased slightly. They have increased somewhat.

Q. Now, will you explain Chart 215—the chart, Exhibit 214, shows only the two matters which you have just referred to, does it not?

A. That is all, yes, sir.

Exhibit 215 is a photostat from this publication of the New York State Labor Department, the Statistical Division, thereof, and it simply brings the earnings which were shown in a chart in my previous exhibit, that is, the weekly earnings of factory labor in New York State, down to December, 1941. The last figures that we brought in before were July, I believe. They were \$33.48 and, in December, they were \$35.78. They have continued their trend.

Q. Dr. Friday, this table supports your Graph B that was presented in connection with your former testimony, does it not?

A. That is correct, sir.

Q. You did not at that time present the table but presented only the chart, is that correct?

A. I presented only the chart, yes, sir.

Q. Now, will you explain Exhibit No. 216?

[fol. 9358] A. Exhibit No. 216 is a table prepared from the Bureau of Labor Statistics' September 15 pamphlet on cost of living and, from the subsequent releases that the Bureau of Labor Statistics has made on the cost of living, it shows in the first column the index of cost of living based on the years 1935 to 1939 as 100. Those are the years used by the Bureau of Labor Statistics. The index of wholesale prices appearing here is the Bureau of Labor Statistics' wholesale prices as they appeared on Exhibit No. 212. These are the annual figures. Using these figures and taking the years 1935 to 1939 as 100, I have converted the Bureau of Labor Statistics' wholesale prices to an index which appears here. When I testified last, in December, the last figures available were in July and the

Bureau of Labor Statistics' cost of living figures stood at 105.3 and, in January, they were 111.9.

Q. You said you testified in December?

A. It was September.

Q. September or October.

A. They came out yesterday for February also and they are still a little higher than this.

Q. Dr. Friday, you did not present the table in connection with your former testimony but presented a chart reflecting the same information, did you not?

A. That is correct. It seems to me this would be more convenient for everybody to use.

[fol. 9359] Q. Your former chart was "D"?

A. That is correct, sir.

Q. Dr. Friday, have you reflected this information which is shown on Exhibit No. 216 on a graph brought down to date?

A. I have. That is Exhibit D in the former testimony brought down to date.

Q. And it is what exhibit number?

A. That is Exhibit No. 217.

Q. Will you explain what the two lines on that graph represent?

A. The dotted line represents the course of wholesale prices and they are taken from this Exhibit 216 and from the price index as there compiled and the solid line is the same index, Bureau of Labor Statistics index from 1913 to date as shown on Exhibit No. 216 and they have simply been placed upon this graph which has been marked 217 and show that during the last year, especially since the spring of the year, since March, the rise in the cost of living has been a marked rise. It has gone up 11.6 per cent.

Q. Dr. Friday, from the middle of 1938 to about March, 1941, how did the cost of living curve run?

A. At the middle of 1938, the cost of living was just a shade below 100. In fact, it was at 99.7. It sagged a little in 1939, frankly, then it remains stable without any rise, any material rise at all until February, 1941, and after [fol. 9360] that it began to rise and from March on, it has had a rapid rise.

Q. What has been the increase from March to now?

A. There has been a 10 per cent increase.

Q. How much?

A. Ten per cent increase from March, 1941, to January, 1942.

Q. Dr. Friday, so far as you have learned, has there been anything which would have a tendency to retard the increases shown on the various trends about which you have testified from this time forward? A. No, sir.

Q. Has there been anything happen which, in your judgment, would cause increases in those trends?

A. I doubt it. I doubt whether there is anything that will cause increases now. We have finally gotten some action on the question of price fixing and price determination. Nothing seems to have been done about labor, however, and the cost of living has finally come to rise markedly. While there may be other forces that might work a little in the opposite direction, I do not see that the rise in wages or in the cost of living either will fall. Of course, they do not run the same month by month but the factors which were at work and have been at work in the last year, year and a half, which are generally at work during wars, are at work here.

In my own opinion, they will continue to rise steadily as [Vol. 9261] long as the war continues, however long that may be, and with the policy we are pursuing now with respect to the restriction of production, especially of the production that people need for the maintenance of their ordinary standard of living, we are certain to have, at the close of the war, a pronounced rise just as we did after the last war.

Cross-Examination

By Mr. Littman:

Q. Dr. Friday, I am not sure that I understand your last few statements. Is it your testimony that you expect prices to continue to rise? A. Yes, sir.

Q. You do not know of anything that is going to check the continuance of the rise?

A. Nothing that is going to check it any more than it has been checked here in these last months.

Q. Is it your opinion that the Government's efforts to check the rise in prices will be unavailing?

A. Not unavailing, no. I think the Government has checked or retarded the rise in prices in many commodities already but I think such a rise at the rate which you have had here will certainly continue because, while it is doing some things to check the rise in prices and has succeeded in checking them in some considerable degree [fol. 9362] there are other things that do not operate in that direction, particularly our policy with respect to agricultural prices which are well known and have been stated in the last year and the cost of labor. With respect to those things, we are bound to have continued rises.

Now, as I see the way in which it works, we have gone now—

Q. (Interposing) You mean they will continue to rise as fast in the future as they have within the past year?

A. Wages?

Q. Yes. A. Yes, I think so.

Q. How long do you expect that to continue in the future?

A. I expect that to continue as long as the war continues.

Q. Then you expect it to continue to rise even after the war?

A. Then I expect it to continue to rise after the war as it did at the last war.

Q. How high do you expect them to go?

A. You mean wages?

Q. Yes.

A. It depends partly upon how long the war continues, how severe the restriction of these consumer goods is. It is a question of how large the deficits of goods, the shortages, so to speak, of supplies of goods, how large they become.

Trial Examiner: In making that statement, are you entirely disregarding the effect of any restrictive legislation which might result in the curbing of wage advances or do you contemplate that also?

The Witness: I contemplate that too. I think there may be some restrictions but they won't be sufficient to freeze wages at this level, in my opinion.

By Mr. Littman:

Q. Have you related any of the data which you just submitted to the operations of Panhandle Eastern Pipe Line Company and subsidiary companies?

A. I have not, no, sir.

Q. You have not made such a study?

A. No specific study of that, no.

[fol. 9364] O. W. Morton, a witness, having been previously duly sworn, resumed the stand and testified further as follows:

Direct Examination (Continued)

By Mr. Culton:

Q. Mr. Morton, several weeks ago you testified concerning your belief as to the volumes of gas that Panhandle Eastern Pipe Line Company will be able to market over the next five years. I believe covering the period 1941 to 1946. Then later, at the request of counsel for the Commission, you furnished Exhibit No. 161 showing your estimated sales and the estimated revenues for those periods divided between various markets. At that time, you indicated considerable confidence in the accuracy of the figures which you presented.

[fol. 9365] Mr. Morton, do you now have the confidence in [fol. 9366] the accuracy of the figures which you presented in connection with Exhibit No. 161 that you had at the time that exhibit was presented?

A. I do not have.

Q. What has happened since that time to cause you to doubt the accuracy of those figures?

A. The war and events connected with the war.

Q. Have you attempted to make estimates concerning the volumes of gas Panhandle Eastern Pipe Line Company will be able to market and the revenue which it might expect to get from that gas during the period covered by the war?

A. I have no studies on that matter. I have made many conjectures. I have tried to get together some figures that would represent my best judgment as to what the sales and revenues would be for the future but I am forced to confess that I do not know what they will be.

Q. What causes the difficulty in reaching a satisfactory conclusion? Can you give us the reasons?

A. Well, as I stated, in general it is facts and matters connected with our entering the war. More specifically, I have in mind the effect of the various priority and limitation orders which have grown out of our entry into a state of war. Even more specifically, I refer to WPB Limitation Order L-31.

Q. That is an order promulgated by the War Production Board?

[fol. 9367] A. It is.

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Q. Has a change in the policy of any of your customers had anything to do with creating difficulties in reaching a conclusion?

A. There is one circumstance that adds, I might say, to my confusion in attempting to predict future sales and revenue related to the change in policy of one of our customers. I am referring specifically to the changed operations of our largest customer, Michigan Consolidated Gas Company.

Q. What has been that change in policy?

A. I probably could describe it better if I reviewed the premise of my former estimate of the amount of gas that we expected to sell to this company over the next five years and the revenues we expected to receive from that sale. The five year estimate I refer to—

Q. (Interposing) That is Exhibit No. 161?

A. The five year estimate I refer to, Exhibit No. 161, was, in so far as the Detroit sales and revenues are concerned, based upon the premise stated in the footnote of that Exhibit 161 which reads as follows:

Estimated unit sales used in calculating revenues to be received from sale of gas to Michigan Consolidated Gas [fol. 9368] Company for Detroit are based upon the following assumptions:

"(1) Michigan Consolidated Gas Company will continue to purchase all of Detroit's requirements under the present two-part rate;

"(2) Panhandle Eastern will carry the peak loads and Detroit will, therefore, earn a unit rate corresponding to a poor load factor. If Detroit should shave its peaks or avail itself of the new so-called 28-40 rate, the average rate would be less than that used above."

Now, that is the premise upon which I built up the sales and revenues to the Detroit company. Since the preparation of that estimate, Exhibit No. 161, Detroit has changed its system of operation and has shaved its peaks. During the cold weather of January, they did not call upon us for 150 million cubic feet of gas on their maximum day as they had advised us they would in a letter which we received sometime last summer or spring. Instead, they only took 110 million cubic feet on that maximum day.

I might add that personally I have no complaint about the fact they did take 110 million because what it did was of considerable assistance to us in carrying our peaks on the rest of our system.

Q. That was a contract right that they had?

A. And it was a contract right that they had so I do not intend to convey the idea that this is in the nature of a [fol. 9369] complaint. It is merely in the nature of an explanation of why the revenues and the sales at Detroit may not be those which I had previously estimated in this Exhibit No. 161.

Mr. Littman: Mr. Morton, may I interrupt to ask whether I correctly understand your testimony to be that the lines of Panhandle Eastern Pipe Line Company were used to maximum capacity on the peak day in the present winter?

The Witness: That is correct. I do not know that I testified to that fact but, if that is a question, my answer is in the affirmative, that our capacity was used fully on the peak day.

Mr. Littman: That is what I wanted to elicit because I gathered as much from your statement that you are, in a

measure, happy that the Detroit Distribution company did not call upon you for the full amount.

The Witness: Yes, that is true. I tried to make that clear.

By Mr. Culton:

Q. What effect on your estimates would their failure to rely upon Panhandle Eastern Pipe Line Company for their entire supply have with respect to Exhibit No. 161?

A. That would tend to earn for them a lower rate.

Q. A lower over-all rate? A. Yes.

Q. To them?

[fol. 9370] A. Yes.

Mr. Chamberlain: Wait a minute, lower than what?

The Witness: Than if they had relied upon us for their entire demand.

By Mr. Culton:

Q. Have you been able to determine what that difference would be?

A. There are several other complicating factors that enter into that calculation and due to the multiplicity of those factors, I have not made a definite calculation of it, but I do know that it would tend to be lower than the prices which were estimated and shown in Exhibit No. 161.

Mr. Littman: Can you tell us how much lower in dollars?

The Witness: I cannot.

Mr. Littman: How are we going to know, then, whether it is \$10 or \$10,000 or \$1,000,000 without your giving us some idea?

By Mr. Culton:

Q. You say that your estimates are affected by the operation of Order L-31 of the War Production Board?

[fol. 9371] A. Yes.

Q. In what respect?

A. Well, Order L-31, as I read it, and I have read it over and over many times in the hope that I could understand

fully its meaning, as I read it, prohibits any of the gas distributing or transmission companies from annexing to their lines or taking on any new house heating customers. The inability of the Detroit company to take on any new house heating customers and the prohibition against our delivering gas for new house heating customers has thrown into the picture an added complication which, of course, was not considered at the time Exhibit No. 161 was prepared.

[fol. 9372] By Mr. Culton:

Q. Had you allowed for some increases in customers of that type? A. I had.

Q. How many had you allowed for Detroit, do you recall? A. About 10,000 a year.

Q. Had you also allowed for additional customers of that type in other markets? A. Yes.

Q. All right. What other provision of Order L-31 would make it difficult for you to reach a conclusion?

A. As I read Order L-31, it sets up some very strict rules as to our operations during periods of emergency or during periods when it becomes necessary to use our line capacity to its fullest extent. That brings us down to a consideration of its effect on presently connected industrial customers.

Under L-31, during these periods of emergency, we are—or, rather, the distributing companies are ordered to handle present industrial customers in a manner which is related to the standby equipment of those industrial customers. That is to say that if an industrial customer has standby equipment and can use some other fuel, why, he is going to be required to use that other fuel.

Now, getting a little closer to your question, that complicates our situation considerably in trying to predict future sales and future revenues. We don't know. I say we: I mean Panhandle Eastern—doesn't know how many customers these distributors have who have standby equipment. We don't know how much they were cut off during emergencies, how much they can cut off during emergencies, how many of their customers will go over to some other type of fuel and stay there. We do know that, under the order—and I am still talking about presently connected industrial customers—the War Production Board

may order you to continue service to certain classes of industries, and order you to discontinue service to other classes of industries. So much for the presently connected industrial customers.

Now, the order—and again I must say “as I read it” because I don’t want to pose as interpreting the order, but just merely as an operating man, tell how it seems to me, how it reads to me. As I read it, applied to prospective industrial sales, we are not permitted to connect any new industrial customers, serve them directly or indirectly if they can use any other kind of fuel.

Now, of the increases which we estimated for the coming years in this Exhibit 161, I don’t know how much we can take on under that limitation, because I don’t know how many of the prospective customers that I estimated would be served in the coming years can use other fuel in the [fol. 9374] opinion of the W. P. B.

In cases where a prospective industrial customer cannot use any other fuel than gas, and where a proper showing has been made that he must have gas in his business, then, as I read the order, this prospective industrial customer must provide standby equipment and standby fuel to take the place of natural gas during periods of emergency.

There is one other provision under this section of the order to the effect that by special permission of the W. P. B., any of the two former conditions surrounding service may be waived. That is to say, we may take on a new industrial customer with special permission of the W. P. B.

Now, at this point I must hasten to add again we have no criticism to offer and it is not in the spirit of criticism that we discuss this order in this way. We intend to cooperate with it fully. We think it is O. K. We think it is workable as soon as the order has been thoroughly interpreted for us. We don’t believe that we understand it at the present time, and certainly your estimator feels that he would be going far astray if he would attempt to build up an estimate with the uncertainties that I have related facing him. Another provision of the order calls for interconnections between pipe line companies. It is apparently the plan of the W. P. B., and a nice plan, at that, I believe.

[fol. 9375] Mr. Goodman: Could I ask a question at this time?

Mr. Culton: Yes.

Mr. Goodman: Mr. Morton, you stated that you have a mental condition of uncertainty in respect to this order; is that right?

Mr. Culton: I didn't understand this was for cross-examination purposes. I thought it was for clarification.

Mr. Goodman: No, no.

Mr. Culton: All right.

The Witness: Yes.

By Mr. Goodman:

Q. Now, other than to read the order and attempt to interpret it, what have you done to relieve that uncertainty?

A. We have written the W. P. B. in a serious attempt to get some explanation on some points, and we have tried to get clearance on service to some industrial customers. In other words, we have been cooperative and have worked at the job of trying to understand it.

The Witness: Speaking of another provision of Order No. L-31 that we think is a good provision but nevertheless is one that projects uncertainty into this business of building up estimates. I speak of that provision which we might entitle: "Interconnections." The order provides that we exchange gas under certain conditions with other pipe line companies. That means that we receive gas from [fol. 9376] them and they receive gas from us during periods of emergency. We don't know just what constitutes a period of emergency yet, but we believe that it is a likelihood that all of next winter will be considered a period of emergency, and all during next winter and succeeding winters, as far as that goes. We will exchange gas with other pipe line companies at prices which no one knows. Continuing, I find the manufactured gas provision of the Order L-31 confusing as far as being able to estimate the quantity of gas we will sell and the unit rate we will receive for it.

By Mr. Culton:

Q. In other words, it is the resulting effect of the order that you are referring to now?

A. Yes, that is true.

Q. Rather than interpretation?

A. Exactly.

Q. All right.

A. I have touched briefly upon the manufactured gas situation with respect to our largest customer, but we also have a problem in connection with other smaller customers. Central Illinois Light Company at Peoria has a gas manufacturing plant. Illinois Iowa Power Company at Decatur has a gas manufacturing plant, and there are others. Some are in operating condition and some are not. Order [fol. 9377] L. 31 requires, as I read it, manufacturing gas companies who have equipment on hand and in operating condition, to operate that before they interrupt industrial customers during periods of emergency.

I don't know.

Mr. Littman: You mean before they interrupt industrial customers that are engaged in national defense work.

The Witness: Possibly that is it. I stand corrected on that.

A. (continuing) I am uncertain as to whether or not Decatur is going to be able to start up their plant this next winter. I am uncertain whether Peoria can operate and manufacture gas suitable for combining with natural gas. There are other minor points which I don't recall at the moment in connection with L. 31. I have merely attempted to point out some of the principal causes of my inability to estimate with any degree of accuracy for the future.

By Mr. Culton:

Q. None of these reasons assigned by you are intended as criticism of the order in any way; is that correct?

A. That is absolutely correct.

Q. You are in wholehearted accord with the order. It is just attempting to interpret the results of the order in volume of sales and dollars of sales that gives you difficulty; is that right?

[fol. 9378] A. Yes; particularly at this early date. It is possible and I think quite probable I am optimistic.

enough to believe that inside of a few months we will be able to weigh the conditions that now are confusing, and possibly make some estimates that would be valuable to all of us.

Q. You will have some past by which to estimate the future, in other words, is that the idea?

A. That is correct.

Q. Has there been any slow-down in the company's expansion program that reflects your estimates in Exhibit 161?

A. Well, I assumed at the time we prepared that estimate, since we hadn't gotten all the pipe we needed nor other transmission equipment, that surely by this next winter we would have sufficient capacity to take care of our anticipated load. It looks like now we are not going to get any more pipe, and it appears that we won't have enough compressor capacity for the coming winter, so that, answering your question, in my opinion, there has been a decided slow-down in the expansion program of the company.

Q. Do you know anything about any contemplated war industries near the company's line that might require substantial volumes of gas over the next few months?

A. I am sure we are all agreed that we wouldn't want [redacted] to call names or places, but I can assure you that I have overheard conversations in our own company concerning the location of extremely large plants along our lines, war plants, war production plants. The quantity of gas which they will use has gone to astronomical figures, but, of course, these are only in the rumor stage, as far as I am concerned, at present.

Q. What can you say as to the price of gas that would probably be sold to such plants as compared with the prices you had anticipated the company would receive for its gas?

By Mr. Culton:

Q. Well, now, would you expect such sales to be at higher or lower prices than you have assumed in Exhibit 161?

A. I would assume that gas sold in the quantities I have in mind and for the purposes which I have in mind would

be sold at prices lower than the rates which I assumed on Exhibit 161.

Mr. Littman: How much lower do you think?

[fol. 9380] The Witness: I can't say.

By Mr. Culton:

Q. Are your distributing companies in some way bothered by the operation of Order 31 just like yourselves?

A. Yes, we get letters from them all the time indicating that they don't understand L-31 or how it applies to their business.

Q. In other words, the distributor company has its problems and their problems and other problems are carried on to the pipe line company; is that correct?

A. That is correct.

Q. Is it your judgment that under the conditions which now face the company the unit prices received for gas under existing contracts would be less or greater than the unit prices you had assumed in preparing Exhibit 161?

A. Unquestionably less.

Q. Are you able to determine how much less?

A. I am not.

[fol. 9381] Cross Examination

By Mr. Littman:

Q. Mr. Merton, I want to ask you a few questions at this time.

I gather from your testimony that you no longer have confidence in the estimates which you have submitted in [fol. 9382] Exhibits Nos. 40 and 162?

A. That certainly does, Mr. Littman—that is a correct statement for 40 and 161. I don't recall what 162 is.

By Mr. Littman:

Q. Exhibit 162 consisted of your working papers for Exhibit 40 and Exhibit 161.

A. Your statement is correct.

Q. These estimates cannot now be relied upon for any purpose; is that correct?

A. That is correct.

Mr. Littman: If your Honor please, I move that Exhibit No. 47, entitled "Panhandle Eastern Pipe Line Company and Subsidiary Companies Future Capital Requirements, Gas Transmission Facilities, Liberal Station and Eastward," be stricken. This exhibit—to wit, No. 47—showing the estimated future capital requirements, which was presented by Witness Burnham, was predicated upon the accuracy and reliability of Mr. Morton's estimates of future sales. If Mr. Morton's estimates of future sales, as he has just stated, cannot now be relied upon, it follows that the estimates in Exhibit 47 showing the capital expenditures estimated, in order to take care of those future sales, equally is unreliable and must be disregarded for any purpose [fol. 9383] in this proceeding. I will have something further to say with respect to other exhibits which are bottomed on the reliability of Mr. Morton's exhibits, but I shan't discuss them at this moment.

I would like to have a ruling on Exhibit No. 46 at this time.

Mr. Culton: Mr. Examiner: Those estimates were presented under normal conditions. It is only abnormal conditions which have resulted in their not being accurate, so long as the present war continues. Frankly, I think none of us know where we are on our private business or any other business so long as this war continues. The estimates are what would normally be required if we could get the equipment necessary to supply those markets, and without assuming that we would have force majeure come in here and stop us. Therefore, the estimates are properly admissible for such information as they may give the Commission and the weight that the Commission will take into consideration.

Mr. Littman: If your Honor please, counsel can't blow hot and cold. Mr. Burnham testified that his estimate of future capital additions is predicated upon the estimated peak load sales and estimated annual sales as submitted through Witness Morton. Now, Witness Morton has just testified that his estimates are no longer valid and cannot any longer be relied upon. It follows as an axiomatic [fol. 9384] matter, that this claim which has been submitted through Exhibit 47 for the huge amount of \$36,942,000, for

future capital additions, through the year 1936, is equally unreliable and invalid.

I don't believe counsel for Panhandle Eastern have in any manner shown where this Exhibit No. 47 has any proper place today in this proceeding.

[fol. 9385] Mr. Goodman: I did mention to Mr. Littman what I am going to say, and I think it is a matter worthy of the consideration of the Examiner:

After all, there has been presented in this matter the attitude of a Governmental agency of great importance. The Federal Power Commission is engaged in price fixing activity in this case which, to my mind, is as important in the conduct of the war as is its function in peacetime.

[fol. 9386] The price of gas in wartime is, I think, perhaps more important than in peacetime.

Now, Mr. Morton spreads the infection of uncertainty from his own attitude, which he derives from an order of the War Production Board. It is unfortunate that he should interpret a thing in that way which, to my mind, is clear, but if his interpretation—that is, of utter confusion—is deemed to have any weight, I think that the Federal Power Commission and its properly constituted authority should bring over into this case the agency of the War Production Board and see if they will not for the benefit of regulation clarify those uncertainties.

Mr. Culton: It was not uncertainties that this witness was talking about. It was the effect of the order in its actual operation. There were some uncertainties that other people had in mind, but it was the effect of the order that he was talking about.

Mr. Goodman: I don't want to inject confusion. I asked him a plain straightforward question to develop his mental condition, and I got an answer which I thought confirmed the implication which I made: he was uncertain.

Mr. Culton: As to the effect.

Mr. Goodman: Well, all right.

Now, in my mind, there is no uncertainty about the terms of the order, its purpose and its purport. The order is [fol. 9387] predicated upon the desire to prevent a diversion of a necessary gas use to an unnecessary gas use. It is for the purpose of utilizing to the maximum the capacities of Panhandle Eastern or other gas pipe line companies so as to do the least damage and so as to have gas available for military purposes or other necessary purposes. Gas is always a very necessary commodity. The effect of that order could scarcely be to diminish in any substantial way the quantities of gas which will be transmitted. The effect of that order can hardly be to keep in the ground that which, in the present emergency, should be used. The purpose of the order is to promote utilization and to prevent waste. Now, if there is any doubt about that, I think that the War Production Board should be asked by this Commission, who has the power of regulating prices, for an explanation—

Mr. Culton: There is no doubt about that. It is erecting a straw man.

Mr. Goodman: Now, wait a minute. And should that situation exist or, for a moment, be indulged in, we, who take this task of regulation seriously, have a serious complaint, for, in that instance, the order, by its terms, would be a misconceived effort and a detrimental effort, so far as the conduct of the war is concerned.

Mr. Culton: There is no question as to the desire of the War Labor Board, Mr. Examiner, raised here at all, or [fol. 9388] the purpose of the order.

Mr. Goodman: Well, there is an incidental question as to their competence to draft a significant order.

Mr. Culton: No, there isn't. It is the economic effect is what the witness has referred to.

Mr. Goodman: I am afraid, Mr. Culton, that you are confusing the entire subject in a mass of verbiage.

Mr. Culton: I am not going to let you get me placed in an erroneous position before the War Labor Board. That is why I want that clear. We are not complaining about the order in any way.

Mr. Goodman: You don't need to complain, but your interpretation is a reflection upon the purposes of the order.

By Mr. Lee:

Q: Mr. Witness, despite all you have said this morning, isn't it true that the Panhandle Eastern Pipe Line Company is selling more gas today than it ever sold in its history? A: That is correct.

Q: And despite all you have said this morning, isn't it true that you expect a continuation of that maximum sale and an increase therein due to the war situation? [fol. 9389] A: I expect the facilities of this pipe line company to be pretty well used for transportation of natural gas, yes. I don't expect it to ruin our business.

Mr. Littman: It is pretty close to a one hundred percent load factor, as a matter of fact, is it not?

Mr. Lee: That is just what I was going to ask the witness.

The Witness: Well, I couldn't say that.

Mr. Littman: Approximately?

The Witness: I wouldn't say even approximately.

By Mr. Lee:

Q: Now, Mr. Morton, your attitude on the stand today and your testimony that you are somewhat baffled and confused and therefore can't anticipate the future, all of that fades into insignificance compared with the fact that you do know—and you are certain in your own mind, I take it—that you are going to be pushed to your utmost because of the war effort, to produce all the gas that you are going to be called upon to produce. Now, isn't that true?

[fol. 9390] It is a superlative situation, isn't it? It is an unusual situation?

A: I can't say that it is a superlative situation, but I can agree with you this far, and I think you have helped

clarify the issues here as I have heard them. I think business is going to be good for Panhandle Eastern. I think we are going to sell a lot of gas. I don't mean, for a minute, to imply that we won't need all the facilities we have said we need to get this gas to the place where we want to sell it.

My principal confusion, if I made that plain, lies in the price we are going to get for it rather than in the quantity to be carried.

By Mr. Littman:

Q. You can't tell us how much the price will be affected in the future?

[fol. 939L] A. No, I can't.

Q. How are we going to know? How are we going to tell, if you can't tell? Can't you assist us in that regard? You haven't made any computations or calculations, have you?

A. I have no formal computations or calculations. I have sat down with a scratch pad in here, made lots of figures on it, tried to visualize the future.

Q. But you are not at all certain about it?

A. No; I am not. That is the crux of the whole matter.

Q. Mr. Morton, is there anything in the War Production Board Order 4-31 which you interpret to mean that your company will sell less gas in the future than it sold before the order was issued?

A. The order says that we can take on no more house heating. I take that to mean that we will sell less house heating gas than we had anticipated. The order says that during times of emergency—and that is not very well defined, what emergency is, but I take it during peak times—industries, certain industries will be cut off from the lines. That would indicate a diminution, in my mind, of the sale of certain classes—

[fol. 9392] By Mr. Littman:

Q. You completed your answer, didn't you?

A. The order says that with respect to anticipated sales which we might wish to make or be counting on making, or prospective sales, that there will be considerable limitation thereon about those.

On the other hand, as offsetting factors, the order says that we are to make interconnections with other pipe line companies and sell them gas and they, in turn, are to sell us gas where, in the judgment of the War Production Board, or words to that effect, such sales are necessary.

By Mr. Littman:

Q. If you wish to go along, Mr. Morton, with respect to those industrial sales that you say you may be required to curtail, the reason for that will be because you are going to have to sell that industrial gas after curtailment to another industry which is engaged more closely [fol. 9393] or more vitally in connection with the war effort; isn't that correct?

A. That sounds like the meaning of the order to me.

Q. Yes; and you are not—

A. (Interposing). The best utilization of our resources to promote the war effort. I think that is what we are all after, too.

Q. In other words, this particular item you are speaking of, industrial gas, will not result in any diminution of your industrial sales, will it, but merely in a reallocation, so to speak, of the sales?

A. Now, it might work out that way. It sounds to me like that is what they intend to do.

[fol. 9395] By Mr. Littman:

Q. Mr. Morton, you don't expect the firm gas sales to diminish by reason of the War Production Board order No. L 31, do you?

A. To this extent: I can see some diminution. Many of the industrial plants in Detroit are served under firm contracts, firm agreements. As a matter of fact, all of the industries, as far as our deliveries to Detroit are concerned, are firm deliveries.

Now, to the extent that some of those plants might be curtailed, their operations curtailed, discontinued by this order, then, I see a diminution in the firm sales of the [fol. 9396] company.

Now, if you speak of them as a whole, why I expect that we will sell as much or more firm gas than we have been selling in the past.

Q. You have made no investigation of the Detroit industrial situation which you just spoke about, have you?

A. Yes, I am fairly well informed on that. You say have I made any investigation. I haven't, of course, gone up there and gone around personally to these places and asked those questions, but I do talk to the men of the Detroit company, representatives of the company, occasionally, and we have letters from them, so we stay fairly well informed on the matters to which I have testified here.

Q. Now, let's take an industrial customer in Detroit. If a particular industrial customer in Detroit is curtailed by reason of W. P. B. Order L-31, that gas will be sold to another industry more closely associated or connected with the war effort; isn't that correct?

A. The order doesn't say that that is what will be done.

Q. Don't you interpret the order to mean just that?

A. Well, I believe I said before, and I certainly, in general, agree that they intend for the pipe line company to use its facilities to the best advantage, and it is my opinion that where they cut off one industry, they will [fol. 9397] try to sell it to another industry or try to allow the company to sell it to another industry.

Q. So there would not be any curtailment over all in the sale of that gas, would there? That naturally follows, does it not?

A. That follows. I expect the sales of this company to go right forward. I don't expect us to go broke.

Q. Mr. Morton, your company bought Michigan Gas Transmission Corporation and paid more than \$10,000,000 for it after Order L-31 was issued, did it not?

A. I believe that is correct.

Q. Panhandle Eastern was not worried about any adverse effects of Order L-31 upon the sales of Michigan

Gas Transmission Corporation, was it, when it purchased that corporation?

A. I don't imagine they were.

[fol. 9405] Trial Examiner: You are referring now to the order of the War Production Board, L-31?

Mr. Culton: That is right. We do not say that we are not going to continue to produce and transport all the gas which we physically can produce and transport under such facilities as we now have or may be able hereafter to get. The management of the company will later present some facts dealing with that particular feature. Frankly, we hope to increase our capacity above what it now is. The services of our gas are needed by certain industries and, if at all possible, we expect to furnish that gas.

We had also hoped to have some other markets available at this time. Because of our shortage of material, those markets are not yet available. We, of course, so long as this order is in effect, cannot say what the ordinary economic effect of conditions will be because there is a matter which now intervenes between us and those ordinary economic conditions on which the former plans had been based.

For example, Mr. Barton referred to a projected plant [fol. 9406] near Kansas City. I do not know whether he stated the volume but the possible volume of that plant, I think I can say, if it materializes, will be probably 25 million cubic feet per day. There may be many other plants of the same kind or for different war purposes constructed at various points along this long line of pipe line.

Obviously, most of the sales which we make, even though we are able to sell more gas than we have sold in the past, even though we get an increase in our capacity and are able to operate to the fullest safe capacity and by that I do not mean 100 per cent capacity factor because it is practically impossible without spare units which we cannot obtain at this time, irrespective of how much gas we sell, we know it will have to be sold, if it is sold, for purposes like that at prices cheaper than we have assumed.

we would be able to sell the gas which we now know is going to be cut off. Therefore, it is not the question of volume of sales that we are presenting here. It is the question of diversity of sales. We know some portion, we do not know how much, but we do know some portion of our higher priced gas is going to be cut off and that portion must, of necessity, be sold at the lower prices and we are not attempting to hold the higher price markets but we are gladly cooperating in any way we can with the WPB and will continue to do that.

The point is that estimates heretofore made, based on [fol. 9407] normal conditions, cannot apply to the abnormal conditions under which we are now operating. Mr. Morton, I believe, stated that he had hopes that, after a few months, there might be some kind of a trend which would enable him to make some kind of an estimate with respect to these various sales at the respective markets and the prices for which the gas was sold but, obviously, until there is some history on which we can base his estimates, the estimator cannot make estimates because he can only gage the future by conditions of similar type existing in the past.

That is the position of Panhandle Eastern on this matter, Mr. Examiner, and that is why we had hoped we would be permitted to have 120 days in which to observe the effect of this order, not the interpretation of the order so much. There may be some questions that may need interpretation and if so, of course, the WPB will render the interpretation we requested but our point is that it is the effect of the operation of the order which we cannot determine at this time.

Trial Examiner: May I ask, Mr. Culton, whether you are in agreement with the statement made by Mr. Littman before luncheon that the industrial sales, based on evidence in the case to date, constitute less than 10 per cent of the total sales?

Mr. Culton: You mean direct industrial sales?

Trial Examiner: Yes.

[fol. 9408] Mr. Culton: That is true, Mr. Examiner, but the record—I am not certain that the record in this case

shows—but I know the record in Docket G-240 was to the effect that our principal customer, the Detroit company, had some 1500 to [200] industrial consumers to which it markets gas and a similar situation exists with respect to our other distributors.

Trial Examiner: May I ask whether, conceding, of course, that the War Production Board might divert any gas to any necessary use under its general powers, may I ask whether you made any apprehension of the curtailment of domestic service which you are now rendering?

Mr. Culton: We do, Mr. Examiner.

Trial Examiner: On what is that based?

Mr. Culton: On the right of the War Production Board, if they think it is necessary in the public interest, to require curtailment. The present order, of course, only prohibits certain increases but there is no reason why the War Production Board might not, at some time in the future, extend that to ordinary domestic use.

Mr. Littman: Mr. Culton, in connection with the Trial Examiner's inquiry, I would like to have you point out any part of the War Production Board Order No. L-31, which could conceivably result in any lessening of your present domestic load?

Trial Examiner: Just a moment at that point, Mr. [fol. 9409] Littman. The inquiry I addressed to Mr. Culton had no relationship to the specific provisions of the present outstanding order. I asked him if he had reason to expect, any reason to expect that there would be a curtailment of domestic service. It is, of course, clear that the War Production Board Order L-31 speaks for itself and that does not in any way intimate a curtailment of domestic service, as I read it.

Mr. Littman: That is the way I read it.

Mr. Culton: We do not so contend. I thought the Examiner was inquiring as to the future, if we were wondering something about the future of that and we are.

Trial Examiner: I was wondering if you have any information as to a future order—

Mr. Culton: (Interposing) We have no such information. Mr. Wheat has some knowledge on other phases.

Mr. Wheat: May I say in that connection, Mr. Examiner, I have spent most of the last three weeks in consultation with the War Production Board in connection with telephone communication and there the first order, L-50 which came out about sixty days ago contained no particular intimation of a possible rationing of telephone services.

I may say now that the War Production Board has in contemplation, for publication probably during the current week, three additional orders, the result of which will unquestionably be the start of rationing telephone service in this country. I think that that is an excellent [40-9410] illustration of what we may be confronted with in the natural gas business.

Trial Examiner: Thus far, however, it is merely on your part, the recognition of a possibility?

Mr. Culton: That is right.

Mr. Littman: That is kind of speculative, I would think, so far as the gas business is concerned.

Trial Examiner: May I ask further, Mr. Culton, whether you have any reason to expect that you will be able to derive less per unit of industrial gas in your future sales pursuant to Order L-31 than you are now deriving?

Mr. Culton: Unquestionably, Mr. Examiner.

Trial Examiner: For what reason do you say that?

Mr. Culton: There will be a greater volume of what used to be referred to as direct sales. Some of it was formerly referred to as "dump sales."

Trial Examiner: Those are sales by negotiation?

Mr. Culton: That is right, but most of those sales are sales to the United States Government where the price is practically dictated. I say "dictated". We have traded with them and we have made agreements in some respects but, obviously, we are not going to hold up some plant with an unreasonable demand for prices.

Most of those sales are on prices below the prices at which our industrial gas is sold under the firm contracts. [fol. 9411] By that I mean the average price that we receive and the management is unable to say what that price is going to be but we will present, at the hearing which we expect to have a few days from now, a management witness who will explain his views.

Trial Examiner: You, of course, recognize the factor of the service company's rights when it is delivering under order of the Government?

Mr. Culton: That is right.

Trial Examiner: And if you cannot agree with the customer, you will have your recourse.

Mr. Culton: If we cannot agree with the Government, they will take the gas and condemn it.

Trial Examiner: They will take the gas but they will pay you on the basis of its worth and your rights, as established.

Mr. Culton: That is right. We do not want to do that. We are not forcing the Government to any such step as that.

Trial Examiner: I am merely reaching for the effect of these things we are discussing on future revenues.

Mr. Culton: Our difficulty is we know there is going to be some effect and we cannot determine what the impact of that will be. That is our point. We expect the unit price to be less.

Mr. Littman: Less than what?

Mr. Culton: Less than the present unit price of sales.

[fol. 9418] Mr. Littman: May I interrupt to state you estimated the maximum day's sales for Detroit to be 164,500 M.c.f. as shown in Column E of Exhibit 40 which contains your estimate.

The Witness: Yes, Mr. Littman, and I might point out that was before Pearl Harbor.

[fol. 9419] Mr. Littman: You just learned that Michigan Consolidated advised you that they were going to have a requirement of something very close to that amount.

Mr. Culton: How much did they estimate they would require last winter on the maximum day?

The Witness: We have a letter that very much resembles the one we are talking about here and that letter states their requirements were going to be 150 million.

Mr. Culton: What was the maximum they took this last winter?

The Witness: They took 110 million.

Mr. Chamberlain: Are you sure about that amount, Mr. Morton?

The Witness: Yes, I am sure about the 150 million and I am sure about the 110 million.

[fol. 9420] Q. Mr. Morton, you expressed concern about a change of policy of the Michigan Consolidated Gas Company, your largest customer. Your concern was, I take it, [fol. 9421] with respect to the estimates that you had made in your Exhibit 40?

A. I believe the term "concern" is a misnomer there because I had no particular concern over the matter, Mr. Chamberlain.

Q. I understood that you were very much concerned about the estimates that you had made a few months ago and that that concern arose largely over the fact that Detroit had changed its policies in respect to the use of its standby equipment.

A. I made the statement that they had changed their policy and, of course, I was making comparisons between my estimate and what they took.

Q. Why were you concerned then? Did you expect the results which would follow would be different [then] your estimate?

A. Possibly this will answer your question. I think their change in policy, abandoning the old manner of taking their full peak demand from us and going to the original contract, as we call it, or going to the basis of supplying a large part of their own peak, did make some difference in the result.

[fol. 9422] Q. Well then, you calculated that the estimates which you had made would not be accurate because of that change of policy, is that right?

A. You say I calculated. Can you put that in the present? Do you mean to say that in comparison with my estimate that I did make last summer?

Q. I assumed you were here to inform the Commission that the estimates which you made with respect to the prospective sales to the Michigan Consolidated Gas Company, as reflected in your Exhibit 40, could not be relied upon and that the reason was largely due to the fact that they had changed their policy with respect to the use of their standby equipment, am I correct about that?

A. That is correct.

Mr. Littington: By "they", you mean Michigan Consolidated?

Mr. Chamberlain: Yes.

Q. Now, let us take Exhibit 40. You estimated in 1942 that you would sell that company 27 million M.c.f., did you not? A.—Yes, sir.

Q. And that their maximum day would be 142,000?

A. Yes, sir.

Q. And you further estimated that the cost to them or, that is, the amount that you would receive would be 27 cents? A. Yes, sir.

[fol. 9423] Q. In other words, that your revenues for 1942 would be \$7,290,000. That was right, was it not?

A. Yes, sir.

Q. Now, let us go back to your estimate for 1941. How far did you miss that, if at all?

A. If I recall it, the error was small.

Q. You estimated 26.2 cents, did you not, for the gas?

A. Yes, sir.

Q. And you actually got 26.34 for it, did you not?

A. I do not have that figure in front of me but it is my recollection that that is a fair statement of it.

Q. And the company took very close to the 24 million M.c.f.?

A. As I recall it, yes. I do not have the actual figures in front of me.

Q. Now, we approach 1942 and your estimate there was that the sale would increase by three million M.c.f., was it not? A. Yes, sir.

Q. And you spoke about a demand of 145 million feet. Was there ever any agreement that you know of on the part of your company to furnish more than 125 million feet to Michigan Consolidated Gas Company?

A. No, there was no agreement to furnish any more. That is the contractual obligation of the Panhandle East- [fol. 9424] ern Pipe Line [Line] Company.

Q. And at no time have they agreed to exceed that amount, have they?

A. To my knowledge, that is correct.

Q. I would like to have the record show just what Michigan Consolidated Gas Company did, in the way of its practice, to change the result of your estimate? Will you illustrate that by what happened during your peak load period in January?

A. I presume you are speaking of the calendar year 1942?

Q. I am.

A. I think we can shortcut your question and my answer by saying that, for the calendar year 1942, there will probably be very little difference in the unit rate of gas to Detroit under the method I used in the summer when I prepared Exhibit No. 40 and under estimates which might be prepared now but the principal difference would come in the fiscal period, March 1, 1942, March 1, 1943, rather than the calendar year 1942.

Q. I apparently did not make my question plain, Mr. Morton. What I would like to have you get into the record is just what Michigan Consolidated Gas Company did and how it affected its bills to Panhandle Eastern?

A. All right. Michigan Consolidated Gas Company [fol. 9425] made approximately or produced and put into the mains approximately the difference between their maximum requirement of approximately 140 million and their take of 110 million on January 7, the day of the establish-

ment of the maximum demand. By doing that, they changed the basis.

Q. (Interposing). Will it bother you if I stop you right there. Are you speaking now of the maximum demand to Panhandle or the maximum demand to Detroit?

A. Since we are discussing the bill of the Detroit company, I am referring now to the date of the establishment of maximum demand as between Detroit and Panhandle Eastern Pipe Line Company.

A. Now, you asked me as to what happened as a result of that procedure?

Q. Yes.

A. The result is that for the 12 months period beginning March, 1942, and ending April, 1943, Detroit will purchase its gas on a basis somewhat different from that which it has been purchasing in the past, namely, on the original two-part contract and, by doing that, will reduce its pay [fol. 9426] ments to Panhandle Eastern by several hundred thousand dollars, as I calculate it roughly, over that which it would have paid had it stayed on the old rate.

Q. Now, you say you figured that roughly. Would you give us the method of your computation?

A. The general method of computation is to take the 110 million which is the demand and multiply it by the demand charge of 38 cents per therm times 12 months and that gives you your demand charge for the period, March to March, and charge out your commodity which is the amount of gas purchased at 15 cents per thousand or 1.5 cents per therm, add those two together, which gives you the charge under the original contract. That is the method. I think we all concede that will govern during the 12 months period, March to March.

Now, if we want to compare that with the old method of billing or the one that we used prior to this March, if we want to compare it with the supplemental billing, we have to go through quite an elaborate process with which I am sure you are quite familiar also and when we compare the prices under those two systems of billing, why, in my judgment, you get a smaller payment than you would with the old supplemental contract. In other words, I think you have saved some money by trimming your peaks.

Q. Well, save money in what money? By getting it for less than we would if we had bought the entire amount?

[fol. 9427] A. That is my judgment.

Q. What do you figure that Michigan Consolidated Gas Company will save by reason of having cut its peak on the 6th of January last, in the next annual period or fiscal year, as you call it?

A. Do you refer to before the cost of manufactured gas? Which cost do you refer to, Mr. Chamberlain, when you say how much would they save, do you mean the gross saving or the net saving?

Q. I mean the saving off the Panhandle bill.

A. I judge it is between \$300,000 and \$600,000.

Mr. Littman: Is that per year?

The Witness: For the 12 months period.

By Mr. Chamberlain:

Q. Between three and six hundred thousand dollars?

A. Yes.

Q. That their gas bill will be less that year?

A. Yes.

Q. For the equivalent amount of gas? A. Yes.

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[fol. 9428] By Mr. Chamberlain:

Q. Then I take it that it is your judgment that, to the extent of 24 million M.c.f. in the next fiscal year, that it will cost the Michigan Consolidated Gas Company for that amount of gas some \$300,000 to \$600,000 less than the cost in the past year, is that right?

.

(Interposing) 24 million M. c. f.

A. They will probably purchase more than that because 24 million was the quantity purchased for 1941.

Q. Yes, but I am trying to get a comparison of what their gain is going to be in their payments to Panhandle for this gas. It is easier to apply that to an equivalent amount, is it not? In other words, in making a comparison for 1942 under the demand that was established January 6, if we took the equivalent amount of gas in 1942, we would

have, in your judgment, a saving of from three to six hundred thousand dollars, is that right?

A. Over what it would have been had you purchased it on the supplemental contract, yes.

Q. Now, wait a minute. I am asking you what, in your judgment, the saving is going to be. I mean in dollars, not with respect to anything.

A. Your gross saving, I believe I stated, I thought, was between three hundred thousand and six hundred thousand [fol. 9429] sand dollars.

Q. Then you think that your estimate in Exhibit No. 161 of \$7,290,000 is going to be excessive by from three hundred to six hundred thousand dollars?

A. That figure that you are referring to there is for the calendar year and I have been quoting you figures in terms of a fiscal year, March to March.

Q. Yes; how much difference does that make?

A. There is considerable difference between the calendar and fiscal year on this matter that we are discussing. Most of the difference occurs because of the difference between the fiscal and the calendar year.

I believe I might clear it up a little bit by saying that I do not believe that your unit rate that you pay for gas for the calendar year 1942 is going to vary a great deal from what it would have been under the system I used in calculating your 1942 bill in Exhibit No. 40.

Q. What do you mean by that, that we are going to pay 27 cents for the Panhandle Eastern portion of the gas for the 1942 calendar year?

A. Now, I have testified that I have difficulty in calculating sales for the future and, with that reservation, I can [fol. 9430] answer your question by saying that, for the calendar year 1942, your unit rate will approximate the figure you mention of 27 cents to Panhandle Eastern, which, of course, would be in the neighborhood of 34 cents at the city rate.

Q. That would make a full 7 cents to Michigan Gas Transmission Corporation?

A. Yes, it would.

Q. And that then increases their allowance of 6.63 cents?

A. I did not understand whether you made a statement or asked a question.

Q. You say that it would be 7 cents. I am asking you whether they would get a larger amount than they got last year which seemed to have been 6.63 cents per M. c. f.

A. Basing my answer on calculations which I show in my Exhibit No. 40 and in 161, the answer is yes.

Q. Have you any reason to change your belief that the sales for 1942 will be 27 million M. c. f.?

A. Yes, that figure of 27 million no longer can be called my estimate for 1942 for Parhandle Eastern's sales to Detroit and the reason becomes immediately clear and immediately apparent when you realize that you have stopped adding house heating customers. We are not going to get the benefit of the sales to house heating customers this fall which I had estimated you would get and which we would [fol. 9431] get when I made my Exhibit No. 40.

Mr. Littman: Didn't you testify, Mr. Morton, when you were here last, that the house heating business was not a very desirable kind of business from the point of view of your pipe line company?

The Witness: I do not hesitate at all to tell you, Mr. Littman, that, in my personal opinion, house heating is the least desirable business from an economic standpoint that we have on our lines.

Mr. Littman: And to the extent that it is undesirable, you will be relieved by War Production Board Order L-31 from attaching any new business of that character?

The Witness: Yes, that is true.

Q. And it then becomes your feeling that the sales in the Detroit area will be less than the 27 million that you estimated last fall?

A. Well, certainly in so far as house heating goes, the sales are going to be less than those that I estimated that went into that 27 million. However, I believe that your industrial sales or your base load sales, there is a possibility that they will be larger than those I estimated in Exhibit No. 40.

[fol. 9432] Q. You have no doubt that they will be much larger, have you?

A. Yes, I have some doubt because, as I said before, I still do not know just how far Order L-31 is going to operate against sales and other orders that may come along later. I too am expecting more orders of a limitation nature. I have given it considerable thought.

Mr. Littman: May I interrupt to ask the witness a question or two, Mr. Chamberlain, that seems to me to be apropos to this particular line of inquiry.

Mr. Merton: I am going to read to you some excerpts from the testimony of your president, Mr. Creveling, given before the Securities and Exchange Commission on November 25, 1941, in Docket No. 59-38, etc., in the matter of Columbia Gas & Electric Corporation. I read from Mr. Creveling's direct testimony at page 279 from the official report of those proceedings.

"Question: Mr. Creveling, has the defense program caused any additional load on Panhandle Eastern and its affiliates?

"Answer: It has, a very decided one. As a matter of fact, while we do not have the figures here, it is my judgment that probably yesterday, although it is still warm weather, was a peak day for all time for gas deliveries from the Panhandle system.

[Vol. 9433] "Question: And you think that is due, in part at least, to the unusual demands by customers engaged in defense operations?

"Answer: We have checked with certain of our customers and through them with the industries served by them and we find that to be decidedly the case and that was one of the items that undoubtedly had a great bearing on our ability finally to get the priority rating that we did for the material being used in our present construction program.

"Question: What was that priority rating?

"Answer: A-2."

Do you agree with the testimony of your employer, Mr. Creveling, which I have just read to you?

The Witness: Well, the fact that he happens to be my employer, should not have any bearing on whether I agree or not.

Mr. Littman: Do you or do you not agree?

The Witness: I certainly do agree. I have testified here before today that I think we are going to make lots of industrial sales—"business is going to be good" are the words I used. I did not admit there would be a boom, however, as I was urged to admit but I think it is going to be good.

By Mr. Chamberlain:

Q. Mr. Morton, just a few moments ago you told me you thought the unit cost of gas which you had estimated for 1942 of 27 cents would be substantially the unit cost of [fol. 9434] gas for the year 1942 for the Michigan Consolidated Gas Company. Will you tell me how you can arrive at that estimate without knowing and having, as a base, the amount of gas you are going to sell and the amount and character of the use of that gas?

A. Well, I think I used the expression "approximately" and I believe that is about as good as anybody could do under the circumstances. That was my estimate before for Detroit and I believe I also testified before that it was now my opinion that, for 1942, it would not vary a great deal from the estimate that I used previously in my Exhibit No. 40. The principal differences that I see in the future in unit rates do not come within the next nine months of this calendar year but within the next twelve months, the next fifteen, the next eighteen or two years.

Q. Your twelve months is entirely within the fiscal year of 1942, is it not?

A. Sir?

Q. There will be a twelve months period in your fiscal year of 1942?

A. I refer to it as the calendar year 1942.

Q. You do not think the amount of gas that you have estimated would be sold there was very substantial nor do you think the unit price will vary substantially?

A. I think I said that that total amount would be less because of house heating since you are prohibited from [fol. 9435] taking on additional house heating. I said also

that the base load might be up slightly over that which I estimated but it is very difficult for me to tell how much because I do not know the effect of Order L-31 but the estimate I show there of 27 million for Detroit for 1942 and the money I show there in the exhibit -- I am referring to Exhibits 40 and 161 -- should not vary greatly for the calendar year 1942. The principal variations I see are those which occur within the next twelve, fifteen, eighteen or 24 months.

Q. You mean that the variance is going to come in 1943?

A. Yes, I expect things to be considerably changed so that Exhibits 40 and 161, as they show my estimates for 1943, are going to be considerably changed.

Q. And you made an estimate of a less increase in the sales of gas for 1943 than you did for 1942, did you not?

A. Referring to Exhibits 40 and 161, that is true.

Q. And you know that Detroit is getting into tremendous war production?

A. Yes, I have heard so. I know that to be a fact.

Q. You have read that, haven't you?

A. Yes. We have a letter from your company stating the number of defense workers that you were going to have to take care of there in Detroit, naming your maximum demands for the coming winter that you expected to have [fol. 9436] to take care of. Yes, I am familiar with your estimates.

Q. And you have found those estimates very accurate in the past, have you not? I am speaking of the estimates made as to the maximum days by the staff of the Michigan Consolidated Gas Company?

A. Yes, they are usually pretty accurate.

Q. By the way, I wish you would make a note to get the letter that gave the estimate of 150 million.

A. All right.

Q. And bring it when you come again.

A. Almost the exact words of that letter said, "We will expect you to furnish 150 million." That is from Mr. Batten.

Q. Yes; and he was told they would not agree to furnish more than 125 million, was he not?

A. Yes, he was that is the contract.

Q. That is right. Now, if the revenue that you are going to receive this year is to be approximately the same,

the unit price is the same and yet the gas a little less, tell me how shaving the peak load benefited the Michigan Consolidated Gas Company?

A. I believe that I have testified that I did not see much benefit to the Michigan Consolidated Gas Company, one way or another, as a result of shaving peaks for the calendar year 1942.

[fol. 9437] Q. I am going to ask you to give your computation as to how it is going to save them anything for the fiscal year beginning April 1, 1942. Let's get this concrete now and find out just in what way that affects your computations.

A. I should think your own figures would show you that, Mr. Chamberlain. Mr. Batten told Mr. Neuner he had saved a lot of money by shaving his peaks.

[fol. 9438] By Mr. Chamberlain:

Q. Mr. Merton, to get back to this money making, I want to ask you under which of these contracts settlement was made last year, the supplemental or the original?

Mr. Wheat: You mean 1941?

The Witness: On the basis of the supplemental contract.

[fol. 9438a] By Mr. Chamberlain:

Q. Now, Mr. Merton, did you intend to infer that by reason of cutting the peak, the demand charge made by Michigan Consolidated Gas Company to Panhandle Eastern would be decreased over the previous year?

A. I don't know that I made any comparison between the demand charge that would result after trimming your peaks and the demand charge for the previous year.

Q. Well, now, the commodity charge is the same under both contracts, is it not?

A. That is correct.

Q. So that the only difference in the amount of the bills that you render during the year would be in the demand charge, would it not? A. That is correct.

Q. Now, last year a settlement was made under the supplemental contract, was it not?

A. Yes, sir, because that was the cheaper of the two.

Q. And do you have with you the amount of the demand charge for the year—that is, the fiscal year—beginning April 1, 1941? A. I do not.

Q. Is it where you can get it here in the building?

A. I suppose that it is in the files of the Federal Power Commission.

[fol. 9438b] Q. Well, now, what will be the demand charge for the year beginning April 1, 1942, under the original contract as compared with the demand charge under the supplemental contract for the year beginning April 1, 1941?

A. Well, I have neither one of those computations, so that I can't tell what that comparison is.

Q. Well, it would be easy for you to figure this last one, would it not? You have before you the maximum take in therms?

A. Yes. I believe I testified at one time that it was approximately 110,500,000 times 12 times 380 per M.e.f., or stated in therms, would be 38 dollars times 12 times the maximum established on the maximum take amounting to 1,110,161 therms.

Q. The latter figure was the maximum take, was it not, in therms? A. Yes.

Q. The demand charge, then, would be that number of therms multiplied by \$4.56, would it not?

A. Yes, it would.

Q. And will you verify this to see whether it would be \$5,062,343.14?

A. I agree within two cents. I get 16 cents, where you get 14.

Q. Yes. Now, in your estimate reflected in Exhibit 40, [fol. 9438c] you increased the unit cost of gas to the Detroit company from 26.2 cents to 27 cents, did you not?

A. You are now comparing. I take it, the estimate shown in Exhibit 40 and—

Q. (Interposing) 161.

A. (Continuing)—161?

Q. Right.

A. Year 1941 with year 1942?

Q. Yes.

A. The comparison you mentioned is the correct comparison—that is, the correct figures for the revenues which I estimated at that time that Panhandle Eastern would receive.

Q. All right. Now, I think perhaps I can give you the figures that will enable you to give us the demand charge under the supplemental contract, for the previous year.

Mr. Wheat: Which is that?

Mr. Chamberlain: That is for the year previous to the one that began April 1, 1941.

Mr. Wheat: April 1, 1941, to March 31, 1942?

Mr. Chamberlain: That is right.

Mr. Wheat: Thank you. That is what the witness called the fiscal year under the contract.

Mr. Chamberlain: That is right.

A. The maximum base load demand established March [fol. 9439] 18, 1941, was 742,300 therms. Multiplying that quantity by \$4.56, which represents the 12 months charge per therm, yields a total of \$3,384,929.04. This figure of \$3,384,929.04 is the base load demand charge under supplemental contract for the fiscal year April 1, 1941 to March 31, 1942, inclusive.

By Mr. Chamberlain:

Q. Now, to that must be added the demand for the house heating customers, must it not?

A. If we are making a comparison between the demand charges for that fiscal period and the demand charge which would hold for the 12 months fiscal period '42-'43, yes.

Q. And can you do that?

A. No, I don't believe I have enough information here to calculate the demand charge.

Q. Did you get the figures above (indicating)?

A. (No answer.)

Q. Mr. Morton, if that is substantially correct, I don't want to bind you in anyway to it, but I want you to have ample time to check it, but if that is close enough to adopt for the moment, we will go ahead and let you figure it.

A. I am not having so much difficulty accepting the figures you have handed me, Mr. Chamberlain, for the purpose of this comparison, as I am in reconciling the [fol. 9440] theoretical basis, upon which they are prepared, with the facts.

Q. Now, it would have been an easy matter to arrive at that, would it not, by—you have the demand charge upon the base load. All you lack is the house heating demand.

Now, you can take the rates by your company and by deducting the commodity charge, you would have the total demand charge that was paid last year, would you not? Then by deducting the demand charge on the base load, you would have the amount that was paid for the house heating. It seems to me that would be easy to get from the records here in the Commission, and if you wish, I will frame my question so to assume that that is the correct amount.

A. In order that we may preserve evidence of cooperation here and to get along to the answer, Mr. Chamberlain, I will, for the moment, assume that this calculation is correct enough for all practical purposes.

Q. Yes. We want it right. We don't want anything out of the way, but I understand that that is correct, and if that is not, we want to correct it, but now if that be true, Mr. Morton, the demand charge that was paid by Michigan Consolidated Gas Company to Panhandle Eastern, under the supplemental contract, for the fiscal year beginning April 1, 1941, was \$4,497,920.16, was it not?

A. Yes.

[fol. 9441] Q. Now, notwithstanding the peak load shaving in January, the base load demand went up, did it not?

A. Yes.

Q. And how much did it go up?

A. I can't tell from this exhibit which day established the maximum base load, but I presume from this examination that it is—

Q. (Interposing) January 6?

A. (Continuing)—January 6; that is correct.

Mr. Wheat: 1942?

The Witness: 1942.

A. (Continuing). And the amount that it went up, of course, would be the difference between the maximum load—or, rather, would be the base load maximum demand of 954,043 less the previously established base load maximum demand established March 18, 1941, of 742,309 therms, so that the increase from one year to the next, on that basis appears to be 211,734 therms.

By Mr. Chamberlain:

Q. And what would be the increased cost of that were the settlement to be made under the supplemental contract for the fiscal year beginning April 1 last?

Mr. Wheat: You mean yesterday?

Mr. Chamberlain: Yes.

A. It would appear that the increase in demand charge [fol. 9442] for a 12-month period as between the base load maximum figures above mentioned would be \$965,507.04.

Mr. Chamberlain: That is right.

By Mr. Chamberlain:

Q. Now, the cost of gas, then, to Michigan Consolidated, if it be required to settle under the supplemental contract, would be greater by that additional demand charge of \$965,507, would it not, notwithstanding the peak shaving we were talking about?

A. That would have been correct had the conditions obtained that we are assuming here.

Q. That is, there are no conditions, are there, other than if they are compelled to settle under the supplemental contract for the fiscal year beginning April 1, 1942?

A. That is correct.

Q. Yes.

Now, let us go back to the original contract and now tell us what the demand charge will be if computed on the original contract for the year beginning April 1, 1942.

A. \$5,062,334.16.

Q. Now, will you deduct from that the demand charge that was paid last year under the supplemental contract?

A. When you say "last year," you mean last fiscal year?

Q. Yes, I do.

A. Ending April 1?

[fol. 9443] Q. Yes, I do.

A. I am deducting from the demand charge on the original contract basis for the year '42-'43 in the amount of \$5,062,334.16, \$4,497,902.16, which latter figure is the one we adopted a few moments ago as representing the demand charges under the supplemental contract for the period April 1, '41-April 1, '42, and the difference is \$564,414.

Q. What do you have there?

A. I have a difference of \$564,414 even.

Q. Now, you said awhile ago that by the peak shaving there would be a gain if settlement was made under the original contract, did you not? A. Yes.

Q. Then, Michigan Consolidated Gas Company would be required to pay an increased demand charge by \$564,414 if the settlement were made for the fiscal year beginning April 1, 1942, under the original contract as compared with the demand charge of the previous year?

A. That is correct.

Q. Then whatever Mr. Batten may have said by peak shaving would be that portion that he could save out of the difference between 564,414 and \$965,507, would it not be?

A. As I understand your question, you have asked me to subtract from \$965,507.04 another figure of \$564,414. The first figure mentioned representing the difference in the base load maximum demands for the two fiscal years which we have been comparing, times \$4.56, the second figure being the difference between the demand charge for 12 months beginning April 1, 1942, to April 1, 1943, and the demand charge on the supplemental contract April 1, 1941, to April 1, 1942, and I can't see the connection.

Q. Well, let me put the question in another way.

You concede, of course, that the commodity charge remains the same?

A. Yes.

Q. And the only difference in the cost of gas to Michigan Consolidated will be in the demand charge for the fiscal year beginning April 1, as compared with the past year?

A. Yes.

Q. All right. Now, it has one of two options of settlement: that is, under the original contract or under the supplemental contract, does it not?

A. Yes.

Q. Now, if it settles under the supplemental contract its demand charge increases \$965,507, does it not?

A. Yes.

Q. If it settles under the original contract, the demand charge increases over that paid last year by \$564,414, does it not? A. Yes.

Q. Now, you have mentioned the difference between the calendar year, and that your figures in Exhibits 40 and 161 were made on a calendar year basis. Under these contracts, the gas company is required to settle, to start with, under the supplemental contract, are they not?

A. Yes.

Q. Then, the demand charge beginning with the first of April will be increased by about \$80,000 a month, will it not, beginning with April 1, 1942?

A. Let us concede for the purpose of getting along that that is a true statement.

Q. 8 times 12 is 96, isn't it?

A. Yes.

Q. If you have got 12 months in the year, you have got \$960,000, that would be just a shade over \$80,000 a month, [fol. 9446] would it not, increase?

A. Let me point out to you that you are discussing a figure which is the difference in the demand charge applicable to the base load maximum demands for the two years in question. That is not the only demand charge under the supplemental contract. There are other items that enter into that charge.

Q. Well, that is perhaps true, but there is at least that much difference, is there not?

A. There is at least that much difference between the base load maximum demand charges for the two years, yes.

Q. I would think there was more. The house heating demand was greater there in 1941. Then, beginning with April, the Michigan Consolidated Gas Company must pay an increased demand charge each month of something over \$80,000, must they not, under this contract, or under their contracts with Panhandle Eastern Pipe Line Company?

A. I wonder if I could shortcut this; Mr. Chamberlain, by saying that undoubtedly your demand charges are going to be higher for the ensuing fiscal year than they were for the previous—

Q. (Interposing) Well, you have already stated that under one method they would be at least \$965,000 and another would be \$506,000, and there are only two, so I [fol. 9447] think we can concede that.

But now what I want to get at is to compare with your figures in Exhibit 40, I want you to make a rough calculation, and you can use, if you like, the paper I have put on your desk, but to make a rough calculation and let us know about what the increased payments on this demand charge would be during the calendar year 1942, so that we can compare it with your estimates.

In this, Mr. Morton, let me say that an approximation is all we care for, and that you may have all the opportunity in the world to recheck.

A. You want to know what is the difference in total demand charge for the calendar year 1942 on the supplemental basis, as estimated in Exhibits 40 and 161, as compared with three months on the supplemental basis and nine months on the original contract; is that it?

Q. What I want to know, Mr. Morton, is what in dollars the Michigan Consolidated Gas Company is going to have to pay you by way of an increase in the demand charges for the calendar year 1942 over the previous year 1941.

Now, let me say this, and I think you will agree with me that settlements in the first instance are made under the supplemental contract, that any rectification is made at the close of the year and that if it should then appear that the original contract was cheaper, there would be a [fol. 9448] refund made, and I think you will also agree

with me in the first instance, that during the summer months the rate would be cheaper under the supplemental contract, and that in the spring months or the winter months of next year, it rises very rapidly under that contract?

A. Yes, that is true.

Q. What I want to know is about how much money Michigan Consolidated Gas Company is going to have to pay in excess of the demand charges last year during the calendar year 1942.

Mr. Wheat: You are speaking solely of demand charge?

Mr. Chamberlain: Yes, sir. The commodity charge remains the same.

Mr. Wheat: Yes, it depends entirely on the amount.

Mr. Chamberlain: Yes. What I am trying to get at is this: what are the finances of these two companies? How much are we going to pay extra and how much will Panhandle receive extra during the calendar year?

Mr. Wheat: Don't you really mean, Mr. Chamberlain—I don't know, the witness may correct me if I am wrong—how much your company would be paying under whatever basis it pays, based on a take of 110,000,000 as against what it would have paid had the take been one hundred twenty-five or some higher figure?

Mr. Chamberlain: No.

[Vol. 9449] Mr. Wheat: Isn't that what you are getting at?

Mr. Chamberlain: No.

Mr. Wheat: I thought that was the saving the witness mentioned.

Mr. Chamberlain: The inference has been cast here several times that we had a lower demand by reason of this peak shaving. The fact is that we had an increase.

Mr. Wheat: Not a lower demand in actual cubic feet than you had the year before. I am trying to get myself straight as to your point.

Mr. Chamberlain: It is a miserably complicated thing, but we have an increased base load demand notwithstanding the peak shaving.

Mr. Wheat: That I thought was understood, but that there was a saving because of peak shaving below what had been anticipated that you would take. Might we not ask the witness whether that was what he was trying to get at?

Mr. Chamberlain: Yes.

Mr. Wheat: I hope you will let him explain that because if you will, that will help me.

Mr. Chamberlain: Anything you want.

[fol. 9450] The Witness: Using approximate methods on the slide rule, it appears to me that on the basis of the calendar years the demand charge for 1942 will exceed those charges paid for gas in '41 by about 360 or 370 thousand dollars.

Q. Well, how do you figure? It would be over a million, wouldn't it? You say that here is nine months of the period which you say the minimum would be 565,000 on that basis.

Mr. Chamberlain: Gentlemen, may we do this: rather than let Mr. Morton take the time now, may we let Mr. Morton make up the calculation and send it in?

Mr. Wheat: Yes, I think that would help.

Mr. Fulton: I think he should know exactly what you want, though.

Mr. Chamberlain: Yes, I will give until tomorrow.

Trial Examiner: Do you agree also, gentlemen, that Mr. Morton, before he takes up this computation, will review his answers to the question which were given on Mr. Chamberlain's interrogatories, and if there are corrections, let us have them?

Mr. Wheat: Yes, I think so.

Trial Examiner: This is a very important ground that has been covered, and the witness has been making his computations as each question was asked, at the desk.

Mr. Wheat: Yes, we would like to have the witness have that opportunity, and I think it would save a great deal of time.

Mr. Chamberlain: I would be happy to have him have it because these are merely mathematical computations.

Q. What I want is the difference in the demand charge that will have to be paid by Michigan Consolidated Gas Company in 1942 calendar year over that paid in 1941 calendar year. Now, I realize, Mr. Morton, that you haven't the exact figures for March to determine the house heating demand. You will have that in your office probably in a day or two, but in doing that, I have used the March before [fol. 9452] fore.

A. It is based upon 25,000 customers. The only change is in the temperature condition in that month so that it couldn't vary largely. But use either March you want to—this or the last one—because they are very slightly different, but my purpose there is merely to show the cash outlay, by which the demand charge this year exceeds the demand charge next year.

We have got to make provision in our financing here for a million dollars more this year than for last year in the demand charges and it has got to be a matter of cash that is paid if my figures are correct, and I think they will be confirmed.

And, by the way, I might say, Mr. Morton, that my figures indicate that the demand charge of the last year was \$4,218,229, and that the demand charge this year under our contract with Panhandle Eastern will be \$5,223,654.

Now, the latter is approximate but very close, as I understand it, the only difference being just on the slight variation of temperature in the two Marches.

A. I detect there what I believe to be an error. You multiplied the total demand on the original contract by

12 months, and there is only nine months that it will be effective in this calendar year, so that to get the true demand charges that you would pay this year, you will, as I [fol. 9453] see it, take three months on the supplemental contract and nine months on the original.

We are speaking now of calendar—

Q. (Interposing) Just a moment. You are assuming now that we will get onto the original contract which might make a difference one way or—well, it makes no difference in the calendar year, because we have to pay the supplemental contract, do we not? In other words, we will pay under the supplemental contract for the balance of 1942, for nine months.

A. You are making a distinction between the payments that you will make to us for your gas and the ultimate cost of the gas?

Q. Right. Right. I am getting at the cash outlay for the calendar year and that—

A. (Interposing) I am glad we are clearing that point up, because I think we help the record if we both understand each other.

Q. I am doing that for two reasons. One is to show the cash outlay that must be made by the Michigan Gas Company, and during this period as well as to get a comparison with your figures in your Exhibits 40 and 161.

[fol. 9454] Mr. Wheat: Now, repeating once more to get it straight: We are interested in what is developing the total demand charges actually paid by Detroit to Panhandle for [fol. 9455] the calendar year '41 as against the prospective payments that will be paid by the former company to the latter for the calendar year '42.

By Mr. Chamberlain:

Q: In other words, the cash paid within that year. Now, I will say this: I asked Mr. Tuttle to make that and he did it hurriedly here and I haven't checked it, but you will check it to see which is correct there.

Now, Mr. Wheat suggested awhile ago, if I am right, a question that I propose to ask you, and that is this: The peak shaving that you referred to as having been done

by Mr. Batten, under which he made money, was done in order to cut down a take which would have been in excess of a base load demand which was figured on January 6 last, was it not?

A. Would this be another way of stating it satisfactorily to you: That it was done to avoid incurring a larger base load billing demand than that previously experienced?

Q. And but for that the base load demand would have been larger by the amount of gas that was sent out by the company? A. Yes.

Q. That is right. Now, will you look at your own bill rendered for January, and state for the record what that [fol. 9456] increased base load demand would have been, had Mr. Batten taken all of the gas from you that day?

A. As I see it, the base load maximum demand would have become 954,043.

Q. Pardon me. You say it would have become that? It did become that, did it not?

A. Had he taken the entire requirements from us on that day, the base load demand would have been the same as I just read: 954,043, since the takes from Panhandle Eastern do not affect the base load maximum. In other words, whether you took it all or didn't take it all from us, under the supplemental contract, the base load - and that is what we are speaking of when we use the base load term.

Q. Yes, you are right about that. You are quite right.

Now, what would be the effect on the original contract?

A. Under the original contract, you would have created a maximum take from us of some 40,000,000 cubic feet or 400,000 therms.

Q. Not that much, would it?

A. Change that to 30,000,000, or 300,000 therms.

Q. Would it be the difference between the sent out and the delivery that Panhandle Eastern made?

A. Yes.

Q. Which on that day would be about 207,040 therms, [fol. 9457] would it not?

A. On the sixth it would have been 237,000 therms increase, yes. Just as you have stated.

Q. Now, what would that have increased the demand charge to Michigan Consolidated Gas Company under the original contract?

A. Well, if that had been the situation and if that situation had obtained instead of the one that, as a practical matter, is obtaining, it would have increased the monthly demand charge by a considerable amount, being 90,000 a month approximately, as I calculated on the slide rule.

Q. That is right, or a million eighty thousand dollars a year, would it not?

A. Yes, that is correct.

Q. Then, by the use of the standby service, he reduced what would have been the demand charge under the original contract by \$1,080,000 for the fiscal year beginning April 1, 1941?

A. By use of the standby, he reduced the annual demand charges approximately by the amount you stated on the original contracts, but it happens that the original contract would not have been the one that determined the charges between the two companies for that period, since the supplemental would have obtained rather than the demand of 140,000,000—

[fol. 9458] Q. You are just telling us that we have an advantage because we are going to settle under the original contract.

Now, if this had not happened, we wouldn't have settled under the original contract, would we?

A. I believe it is a true statement that you got an advantage by settling under the original contract or you wouldn't be changing over to the original contract.

Q. I don't know how you can tell until the end of the year what it will be.

There is no question, I think, Mr. Morton, in the world, that there wasn't a distinct advantage gained by the use of the standby, an advantage probably of \$340,000 over what the bill would have been, but I think you will concede that the bill for demand charge will be, under the lowest method of settlement, \$64,414 more than last year, and on the former \$65,000 more; that is correct, isn't it?

A. We would expect the demand charge to be more each year because you are adding more business, certainly.

Q. But you complained that you could not arrive at that estimate and that your estimate was now all wet because of that peak shaving. Now, the effect of it is that your estimate is almost a perfect estimate for the year 1942, both as to unit costs and—

A. I testified several times that for the year '42 there wouldn't be much difference between the two.

[fol. 9459] Now, let me ask you two or three more questions here with respect to the take, and I don't mean this in any sense controversial, because I want merely facts.

A. All right, Mr. Chamberlain.

Q. You have here the sendout which I believe you or some of your men furnished from your measuring station at Dana northward for the period from January 3 to January 11? A. Yes.

Q. There was a period in there of some six days that you averaged better than 175,000 M. c. f., was there not?

A. Yes, I recall those figures, so I can testify to them right off.

[fol. 9460] Q. Yes.

The 175,000 M. c. f. is what you deem to be the capacity of your line north from Dana, isn't it?

A. That is pretty close to the maximum capacity of that line.

Q. And you had a continued sendout there for that period of time which I think was a remarkably fine bit of operating, and I think you agree with that, but what I am getting at now is: what did the Detroit company do with respect to limiting that load by its standby service during that period?

A. Well, they assisted materially in limiting that load.

[fol. 9461] Q. All right. Now, let us take the sixth day of January, in which you sent through 175,859 M.c.f. beyond Dana. What amount did Detroit add to that for the purpose of consumer use?

A. What portion of that figure is constituted by Detroit's load? is that the—

Q. (Interposing) No. What amount did Detroit send out which supplemented your load?

In other words, what I am getting at is: What was delivered to consumers on that day, and how much did Detroit contribute to it?

A. On the sixth of January?

Q. Yes.

A. According to the record your send out was 1,347,201 therms, and on that day you took from Panhandle Eastern 1,110,161 therms, so that there was a difference there, which was made up from your own facilities at Detroit, amounting to 237,040 therms, or approximately 24 million cubic feet supplied by your own facilities at that critical time.

Q. Well, then, the service in that area was supplemented by that amount of gas in addition to what Panhandle Eastern was able to deliver through their lines, was it not?

A. Yes.

Q. Now, what was your peak day during that period? [fol. 9462] A. The coincidental maximum day on the Panhandle system occurred on January 7, and it amounted to very close to 254 million cubic feet.

Q. And how much passed the Dana Measuring Station?

A. I will correct that. The figure is 178,868 M.c.f. or 179 million cubic feet approximately.

Q. And how much did the Detroit Company add to that for customer distribution?

A. The Detroit Company added approximately 28 million cubic feet.

Q. And how much on January 8, when your deliveries remained at approximately the same amount, or to be exact 178,324 M.c.f.?

A. Approximately 26 million cubic feet.

[fol. 9468] Mr. Littman: I have a matter that we might dispose of at this time.

Trial Examiner: Very well.

Mr. Littman: It will not take very long, but we might utilize the remaining few minutes.

I have caused to be copied the cross examination of Mr. Joe D. Creveling, president of the Panhandle Eastern Pipe Line [Company,] which testimony was given before the Securities and Exchange Commission on November 29, 1941, in the matter of Columbia Gas and Electric Corporation, et al, File No. 59-33, etc.

[fol. 9469] I would like to have this copy of Mr. Creveling's testimony marked for identification with the next exhibit number.

(The document referred to was marked for identification as Exhibit No. 218.)

(The document referred to was received in evidence as Exhibit No. 218.)

Mr. Littman: As I have stated, Exhibit No. 218 is the copy of Mr. Creveling's cross examination in the proceedings which I just named.

There are, however, some statements that Mr. Creveling made on direct examination, that I think ought to be made a part of this record.

They are not lengthy, and I thought perhaps the most [fol. 9470] propitious way of handling the matter would be to merely read into the record at this point the portions of his direct testimony from the same proceeding, which I deem relevant to the issues at hand in the instance proceeding.

I shall read from Page 277 of the official report of the proceedings before the Securities and Exchange Commission, in the matter of Columbia Gas and Electric Corporation, Docket No. 59-33.

Trial Examiner: That is not contained in your Exhibit 218?

Mr. Littman: That is correct. Page 277:

"Question: Mr. Craveling, I take it that Panhandle Eastern considers that it is most desirable for Panhandle Eastern to acquire Michigan Gas Transmission Corporation?

"Answer: I think that is quite apparent.

"Question: Can you give a brief statement of some of the reasons for that and some of the advantages that would flow from the acquisition of this property by Panhandle Eastern?

"Answer: I think I can give some of them.

"In the first place, from the standpoint of operations and especially as the operations of the various corporations approach 100 percent of the capacity, it is quite apparent that unified management would be more efficient than a divided management.

[fol. 9471] "As an example of that, the item of pressure control is quite important. We, Panhandle Eastern Pipe Line Company, deliver gas to Michigan Gas at a point near the Indiana-Illinois State Line known as Dana. Michigan Gas Transmission Corporation takes that gas and delivers it primarily to our customers in Indiana, Ohio, and Michigan.

"We feel that we have a direct responsibility to these customers to render them as nearly as is humanly possible and economically possible, uninterrupted service in accordance with their varying demands.

"To fully be able to fulfill that obligation, we think it is a handicap to have a third party intervening between ourselves and our customers. We also find out that the customer prefers, in most instances, to deal directly with the owner of the commodity he is purchasing, rather than to deal through an intermediary.

"Question: In other words, the acquisition of Michigan Gas by Panhandle Eastern would afford direct contact between Panhandle Eastern and its customers, present and future, in one of its largest sales territories?

"Answer: That is correct.

Question: Would there be any financial economies in operation, unified operation?

Answer: There would be some economies that undoubtedly would result in the consolidation of the two corporations.

[Vol. 9472] "There would be only one management and a reduction of general expense. There would be some reduction undoubtedly in the operating expense.

"As an example of that, our contract calls for delivery pressure when demanded at Dana of 225 pounds per square inch. A more economical operation of the two lines as a single project would indicate a pressure at Dana of probably nearer 300 pounds in order to most economically utilize the compressor station installation of the two corporations.

"Also, we find every time we approach either investment or commercial bankers, the proposition of this not being a single unit from the source of supply to our principal markets is brought up and is a hurdle that we have to overcome and, undoubtedly, the tendency of this hurdle is to weaken our credit rather than to strengthen it."

Mr. Littman: It is stipulated by and between counsel that the word "uncommon" appearing in the second line on page 516 of Exhibit No. 218 should be corrected to read "a common."

[Vol. 9476] CHARLES W. SMITH a witness called by and on behalf of the Commission, having been first duly sworn, was examined and testified as follows:

Direct Examination.

By Mr. Littman:

Q. Will you state your name and address?

A. Charles W. Smith, 1810 Park Avenue, Halethorpe, Maryland.

Q. What is your present position, and how long have you held it, Mr. Smith?

A. I am chief of Bureau of Accounts, Finance, and Rates of the Federal Power Commission, which position, subject to a few changes in duties, I have held since July 1, 1936.

Q. Will you please describe briefly your education and experience?

A. I have a B. S. Degree in Finance and Business Administration, and also an L. L. B. Degree.

I am a Certified Public Accountant of North Carolina and Maryland, the first having been obtained about twenty years ago.

[fol. 9477] I am a past president of the Maryland Association of Certified Public Accountants and a member of the American Institute of Accountants, the American Accounting Association, American Economic Association, the American Bar Association, and an honorary member of Delta Sigma Pi, an international accounting fraternity, the Beta Alpha Psi, a national accounting fraternity.

I am also a member of the Committee on Statistics and Accounts and the Committee on Depreciation of the National Association of Railroad and Utilities Commissioners, and a member of the Special Committee to report on the effect of national defense laws and regulations on public utilities of the public utility section of the American Bar Association.

I have been admitted to the Bars of the Court of Appeals of Maryland and the Supreme Court of the United States.

Q. How long, by the way, have you been a member of the two committees of the National Association of Railroad and Utilities Commissioners?

A. I was a member of the Committee on Statistics and Accounting back in 1933 or 1934.

In 1936 I resigned my membership because I then became associated with the Federal Power Commission and one of my assistants, the chief accountant of the Commission, was also a member of the committee, and I didn't [fol. 9478] think the two of us should represent the same agency.

I again became a member of the committee in 1937 or '38. I have been a member of the Depreciation Committee for about three years.

For nine years I was an auditor in the Income Tax Unit of the United States Treasury Department, and in this capacity I audited the income tax returns and books and records of practically every type of business corporation, including public utilities.

On June 1, 1929, as the result of obtaining the highest mark in a competitive examination, I became the chief auditor of the Public Service Commission of Maryland, remaining in that position for seven years. I joined the staff of the Power Commission, as I have indicated on July 1, 1936.

For ten years I taught accounting in evening schools in Baltimore, including eight years at Johns Hopkins, where I gave the course in accounting systems, and for two years the course in cost accounting. These courses were for both day and evening students.

While with the Maryland Commission, I did a good deal of work as consultant in accounting, taxation, and finance in my spare time.

On one occasion, I obtained leave of absence to do some work of a consulting nature for the Tennessee Valley Authority, and on two other occasions I was granted leave [for 94/11] to act as consulting accountant to the Federal Power Commission.

On the latter two occasions I was retained by the Power Commission to supervise the drafting of the uniform system of accounts which the Commission later prescribed for public utilities and licensees.

I have written several articles on accounting and economic subjects, including a text on accounting systems for my classes at Johns Hopkins.

I understand that the latter text is still being used. I have delivered a great many lectures, more than 50, on accounting, financial, and economic subjects, including two radio addresses.

I have testified in more than 35 public utility proceedings of one kind or another. While in the employ of the Public Service Commission of Maryland, I had charge of all accounting, auditing, financial and certain rate matters which were under the jurisdiction of that body. This included the making of the usual accounting investigation for all regulatory purposes, all studies relating to the issuance of securities, financial structure, rate of return, and so forth.

I also testified in proceedings before the Maryland Commission as to depreciation matters.

In my present position, I have charge of four divisions [fol. 9480] of the Federal Power Commission, namely, the Division of Accounts, the Division of Finance and Statistics, the Division of Rates and Research, and the Division of Original Cost.

Q. Mr. Smith, when I hereafter use the term "depreciation" in my questions, I include therein also depletion and amortization.

Mr. Smith, have you had any special experience in the field of depreciation? A. Yes, I have.

Q. Will you describe that experience briefly?

A. I have been actively dealing with depreciation matters since 1920.

When I was in the Income Tax Unit of the Internal Revenue Bureau, I necessarily passed upon depreciation claims in numerous, probably hundreds, of cases. In fact, as I look back upon it, it seems that almost every large case involved depreciation in one manner or another.

When I was in the employ of the Maryland Commission, as I just mentioned, one of my duties was to pass upon matters of depreciation expense and accrued depreciation.

Since joining the staff of the Federal Power Commission, I have taken an active part in the functions of the Commission as relating to depreciation.

All staff matters pertaining to depreciation in rate cases [fol. 9481] are handled by the Bureau of which I am the chief. Here again depreciation is involved in almost every rate case.

I have testified in three or four cases before the Commission on the subject of depreciation. Thus, since 1920, I had been constantly applying depreciation principles, I have been determining service lives, depreciation rates, depreciation expense, and accrued depreciation.

In addition, I have been a close student of public utility depreciation matters and have taken a very active part in the work of the Committee on Depreciation of the National Association of Railroad and Utilities Commissioners.

Q. Mr. Smith, what do you mean by the word "depreciation"?

A. Depreciation signifies the expiration or consumption, in whole or in part, of the service life, that is, the economic life or the economic utility of depreciable property, resulting from the action of one or more of the various forces which operate to bring about the retirement of such property from service.

Among the forces which so operate are wear and tear, decay, action of the elements, inadequacy, obsolescence, public requirements, and the exhaustion of natural resources. Thus depreciation is not wear and tear, inadequacy, or obsolescence. These are causes of retirement.

[fel. 9482] Depreciation is the using up of the economic life of an asset, of a plant item:

Plant items are considered merely as stored up services; the automobile as transportation miles; the gas well as so much stored up gas; the pipe line as so much stored up transportation units of natural gas. As these stored up services are utilized, depreciation occurs.

Q. Mr. Smith, are there two phases to the depreciation problem?

A. Yes. One phase relates to depreciation expense, and the other to accrued depreciation, meaning depreciation in the properties as of the date of the inquiry.

Q. Will you explain the difference between these two phases?

A. I have indicated that depreciation expense occurs as the economic life or the economic utility of plant assets used up.

The cost of plant assets is incurred in advance of use. As the economic life of the assets is consumed, a part of the cost of the plant must be charged as an expense.

Thus the cost of leases and wells is incurred in advance of production. Such costs are recorded as a part of the cost of plant.

As gas is produced, depreciation occurs and a part of the capitalized cost should be charged as depreciation expense [fol. 9483] — the word “depreciation” being used in the broad sense, as defined by you, Mr. Littman.

In the early days of accounting, it was the practice to reduce the plant cost by the amount charged as depreciation expense. Thus, if a pipe line had a life of, say, 20 years and each year one-twentieth of the cost of the line was charged as an expense of doing business, the plant item, namely, the cost of the pipe line would be correspondingly reduced.

For the purpose of the mechanics of accounting and for other purposes, such as the giving of more information, the amounts which formerly were credited to the plant accounts, that is, the amounts which reduced the plant accounts, were set up in a separate account known as the depreciation reserve.

The depreciation reserve, therefore, is complementary to the plant accounts. It relates solely thereto. It shows the amount of depreciation which has been recorded in the books relating to the assets still in use.

The reserve, therefore, should measure the accrued depreciation in the properties.

In industrial accounting, it is the practice to deduct the depreciation reserve from the plant cost in order to arrive at the net cost of the plant.

In other words, it is just as accurate today to reduce [fol. 9484] plant costs by the amount of the depreciation which is recorded as an expense as to set the amounts up in the reserve. The latter device does not change the substance in any way at all, but merely is a better arrangement.

A properly computed depreciation reserve, in my opinion, is the best measure of the accrued depreciation in the properties.

Q. Mr. Smith, what is annual depreciation?

A. Annual depreciation is the amount of depreciation occurring in any given year. As I have indicated, it is measured by the estimated cost of the economic life of the plant which is consumed in the particular year.

Q. Is annual depreciation a precise determination or is it an estimate?

A. It is necessarily an estimate because it expresses the proportion of the total economic life deemed to have been used up in a given year.

To determine the proportion used up, it is necessary to know the total life. Naturally, the life of property, as the life of human beings, is necessarily an estimate.

Q. Mr. Smith, have you given consideration to the making of a recommendation to the Commission as to what should be allowed as the depreciation expense of the companies involved in the instant proceeding for the purpose of determining whether their rates are just and reasonable, [fol. 9485] and, if not, the degree of unreasonableness?

A. I have.

Q. What is that recommendation?

A. It is my recommendation that the depreciation expense which the companies have recorded in their books for the last several years, including the year 1941, be accepted by the Commission as a reasonable estimate of the depreciation expense for each of the respective years.

Q. Now, why do you make this recommendation?

A. I have reviewed the minutes of the Board of Directors of the Panhandle Eastern Pipe Line Company for several years which deal with this subject, and those minutes indicate that the company's officers have made a conscientious attempt to determine the proper depreciation expense.

I have likewise read the testimony of Mr. Watkins and have reviewed certain of the exhibits. These also lead me to believe that a serious and conscientious effort has been made by the company to determine the annual depreciation expense.

Discussions with my staff and a knowledge of the natural gas business lead me to the conclusion that the amounts which the companies have set up in their books for depreciation expense are within the realm of reasonable amounts. They are slightly on the high side, but I believe they are reasonable, on the whole.

[fol. 9486]. Inasmuch as the Company has made a conscientious effort to determine the particular item of expense and inasmuch as I believe it has obtained an answer within the realm of reasonableness, an answer which it has reported to the stockholders, to financial publications, to the Federal Power Commission, and other interested parties, it is my recommendation that the amounts shown by the company's books and records be accepted as reasonable for the purposes of this proceeding.

Q. Mr. Smith, have you given any consideration to a recommendation as to accrued depreciation to be deducted in arriving at the rate base?

A. I recommend that the amounts appearing in the depreciation reserves of the companies be considered by the Commission as reasonable estimates of accrued depreciation in the properties.

Q. Why do you make that recommendation, Mr. Smith?

A. I have already indicated that the depreciation reserves are merely complements to the plant accounts, deductions therefrom. They reflect the amounts which have been charged off by the companies as expenses for depreciation for the properties still in use.

The companies have considered such amounts as proper [fol. 9487] expenses and have, therefore, considered the amounts in the reserves as accrued depreciation.

Inasmuch as the reserves reflect the efforts of the companies to arrive at a reasonable figure for the cost of the economic life used up and inasmuch as that figure appears to me to be within the realm of reasonableness, I recommend that it be employed for the purpose of determining accrued depreciation.

Q. What do you mean by accrued depreciation?

A. By accrued depreciation I mean that part of the economic life of plant assets which has been used up to the date of inquiry. The amount which is stated in dollars representing the capital outlay which has expired.

Q. Then you suggest that both for expense purposes and for the purpose of determining the depreciation in the rate base, the company's recorded figures be accepted?

A. I do.

Q. Does this harmonize and make consistent the allowance for depreciation and deduction for accrued depreciation in the rate base? A: Yes, obviously.

Q. Mr. Smith, do you believe that it is sound regulatory practice to require depreciation expense and accrued depreciation, the two phases of the depreciation problem concerning which you spoke, to be treated consistently?

[Vol. 9488] A. Yes.

Q. Why?

A. I have already indicated that these are but two phases of the same phenomenon. It is illogical to say that the consumption of economic life of plant is going on at a certain rate for the purpose of determining annual expense and then to deny that consumption is going on at that specified rate in determining the amount of property which has been consumed at the end of a given period, such as a year.

I believe it must be obvious that, if amounts charged to annual expense represents a reasonably accurate determination on a cost basis of the amount of economic life or utility of assets consumed in a given period, the accumulated amounts in the reserve must represent the accumulated consumption of such economic life or utility.

In other words, only actual expense should be charged to the operations of a given year. There is no valid reason to inflate those expenses.

Depreciation is a normal item of expense. If the expense is valid as measuring the cost of the economic life which has been consumed in any given period, the accumulations of these expense charges in an account complementary to the plant accounts, called the depreciation reserve account, must just as validly represent the cost of

[fol. 9489] the economic life or the utility which has been consumed to date.

I believe it fundamental to the sound regulation of public utilities that depreciation expense and accrued depreciation in the rate base be harmonized in the manner in which I have indicated.

Q. Mr. Smith, for the purpose of the record, will you indicate whether you believe, as a general principle, that depreciation expense and depreciation reserves, as shown by the books of the company, should be used in rate making?

A. Where the expense is clearly not within the realm of unreasonableness, where it is inadequate or excessive, and where the depreciation reserve is greatly inadequate or excessive, corrections, I believe, will probably have to be made. Under such circumstances, certainly it is perfectly proper to restate depreciation expense at the proper rate and to restate the reserve so that it would show an amount which would have been recorded therein, had the proper rates been used. In other words, there are cases where the amounts recorded for depreciation are unreasonable. In such circumstances, I believe it is appropriate to recompute depreciation expense at a reasonable amount and show accrued depreciation at the "reserve requirement," namely, the proper reserve as established [fol. 9490] by the revised rates.

Q. Mr. Smith, do you believe it sound economics of regulation for the Commission to allow depreciation expense on the consumption of economic life principle and in computing the rate base to deduct not accrued depreciation but a smaller amount such as that determined by what is known as the "observed depreciation" method?

A. No. Such inconsistency is a violation of sound economics of regulation and violates sound logic as well. It constitutes both an affirmation and denial of the service life basis of determining depreciation, and, therefore, is illogical and inconsistent.

Q. Does observed depreciation, as usually made constitute proper accrued depreciation, in your opinion?

A. No. Observed depreciation is not based upon the consumption of economic life of plant, and is not, there-

fore, a proper [method] of determining accrued depreciation.

As I have indicated, plant assets are purchased for the services they will render. As this service is rendered, revenues are obtained. A cost of such revenues is represented by the cost of the original service capacity which is used up in the period the revenues are derived.

The observed depreciation process is not based upon the using up of the service or economic life but, rather, upon the physical condition of the properties and, therefore, [fol. 9491] fore, cannot, except by accident, be a proper reflection of accrued depreciation.

Trial Examiner: I show you, Mr. Smith, the balance sheet of the Panhandle Eastern Pipe Line Company marked for identification in this proceeding as Exhibit 172, and will ask you to state what you would include, from that balance sheet, designating the lines or items by name, in what you have termed depreciation or depreciation reserve.

Mr. Culton: Mr. Examiner, may I suggest that you just use the Panhandle Eastern for the purpose of the record? That includes all the subsidiary companies, I believe,—
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Trial Examiner: Do I understand, then, Mr. Culton, that in this proposed Exhibit 172, you have included the figures which were at one time proposed in Exhibit 88?

Mr. Culton: 48 or 88; I don't remember which.

Trial Examiner: The Michigan Gas Transmission Company balance sheet.

Mr. Culton: That is right.

I just wanted to make that clear, Mr. Examiner, that for the purpose of the record we are talking about the entire group of companies in this exhibit.

Trial Examiner: I was about to ask that question myself.

[Vol. 9492] Mr. Lattman: It is my understanding, if your Honor please, that Exhibit 172 covers for the full year 1941 Panhandle Eastern Pipe Line Company and Illinois Natural Gas Company.

Mr. Wheat: That is correct.

Mr. Wheat: Well, there is another exhibit, Mr. Examiner, that has the pro forma including the Michigan Gas Transmission Company. [A]

Mr. Culton: That is right.

Trial Examiner: Very well. We will deal now with Exhibit 172.

The Witness: Mr. Examiner, I have not studied these exhibits in detail. Could I confer with a member of my staff for a moment before answering the question?

Trial Examiner: Yes. And before that may we have this colloquy read back commencing with my original question? In other words, if there is some revision required, to make this question of value, let us have it now. The thought behind the inquiry was, of course, apparent that the balance sheet breaks down the depreciation re- [Vol. 9493] serve on the book into some classifications of depletion and amortization and includes several items instead of a single item termed depreciation reserve.

Mr. Culton: 194 was the exhibit number I had referenced to, Mr. Examiner.

The Witness: Referring to page 2 of Exhibit 172, under the heading "Reserves," opposite line 27, I would include as the accrued depreciation: reserve for depreciation of gas plant—that is lines 28 and 29—reserve for amortization and depletion of natural gas land and land rights, lines 30 to 32, and reserve for abandoned leases, line 33.

Trial Examiner: I show you now an exhibit marked for identification as 194 which, I understand from Mr.

Culton, contains the consolidated [statement] since the acquisition by the Panhandle Eastern Pipe Line Company of the securities of the Michigan Gas Transmission Corporation.

I will ask you to make a corresponding comment with reference to this proposed exhibit.

[Vol. 9494] The Witness: The items which I would include are shown under the title of "Reserves," on page 2 of Exhibit 194, and they are: reserve for depreciation of gas plant, reserve for amortization and depletion of producing natural gas lands and land rights and reserve for abandoned leases.

Now, there may be some adjustment necessary to these reserves by reason of the fact that I understand this exhibit includes a small amount of distribution property, property, I believe, of the Indiana Gas Distribution Corporation.

The amount applicable to distribution property, of course, would have to be taken out of the reserve figures.

Mr. Wheat: You understand, Mr. Smith, don't you, that those are quite negligible in the total?

The Witness: Yes, I understand they are quite negligible. I am speaking now from principle rather than practical application.

By Mr. Littman:

Q. Mr. Smith, my understanding is correct, is it not, that the reserves to which you have just referred on page 2 of Exhibit 194, cover the reserves of Panhandle Eastern Pipe Line Company, Illinois Natural Gas Company, Michigan Gas Transmission Corporation, and Indiana Gas Distribution Corporation?

Mr. Wheat: That is our understanding, Mr. Littman.

A. That is my understanding.

[Vol. 9495] Trial Examiner: Then the items which you have designated by lines and titles are what you would designate as deductible items in arriving at a rate base?

Q. For accrued depreciation? A. Yes, sir.

Cross Examination

By Mr. Goodman:

Q. Mr. Smith, what is the depreciation basis embodied by the company in: first, the accrued depreciation, and in the annual charges for depreciation?

A. I think the company has made a serious attempt to find the cost of its expired capital outlay.

In other words, I think the company has made a serious attempt to apply the consumption of economic life principle, which I have mentioned in my testimony.

[fol. 9496] Q. Now, without knowing the individual lives, which, composited, amount to the composite basis, how are you able to state that the composite basis is reasonable?

A. In the natural gas industry, as in the case of all extractive industries, your controlling factor is the life of the natural resource. It is better to be a little conservative in your estimates of the natural resource, in order to arrive at your over-all rates.

For instance, we know that a natural gas pipe line may last 75 or a hundred years. We found in one case 30 years was clearly indicated, and there are some cases, depending upon soil conditions, where the pipe will last many, many years, probably more than a hundred years.

Mr. Littman: You are now speaking of physical life?

The Witness: I am speaking of physical life.

A. (Continuing) But because of the exhaustion of [fol. 9497] the natural resource to which their economic life is tied, you can't possibly use that life without courting disaster. You have got to use the life of the field.

We have made a great many studies of depreciation; a great many studies of over-all rates. We made studies recently of the Canadian River Gas Company, Colorado Interstate Gas Company, and the Colorado-Wyoming Gas Company. We made studies of the Hope Natural Gas Company. We completed studies of the Interstate Natural

Gas Company. We are engaged in making studies of the United Gas Pipe Line Company, the Cities Service Company, and the Lone Star Gas Company.

Such studies are generally under my direction. I can state, from my knowledge in all these studies that the rates which the company has used appear, on the whole, within the realm of reasonableness.

Mr. Wheat: Pardon me just a second, Mr. Goodman. You mean by the last portion of your answer that the things which have been done by the companies which are respondents here in this proceeding appear within the realm of reasonableness?

The Witness: That is correct, yes.

By Mr. Goodman:

Q. Well, I interpret your answer as responding to my question in this wise: That in judging of the composite life [of 9493] for the property, you took into consideration life of pipe as long as 75 years. Now, do you mean to answer that? A. I didn't answer that at all.

Q. That is the way your answer seems to read.

A. Well, you misunderstood the answer, Mr. Goodman.

Q. Well, now, let's see if you understood the question. Is it right that you use a composite life?

A. I didn't use any life. I said the company's life is within the realm of reasonableness on a composite basis.

Q. All right.

Now, what life is the company's life?

A. The company, generally speaking, is using a life somewhat more than 33 years on an over-all basis.

Q. And is this an actual life or what you term a life composed out of different accounts?

A. It is a life—they started off originally by a composite method, and then they changed that method because of the predominance of one factor which appeared to be controlling as to most of their properties, namely, the reversible gas.

It is a fundamental principle of depreciation, of course, at where one factor controls, that has to be given sole

weight. So where you have, as we always have, in extractive industries, one factor which predominates, namely, [fol. 9499] recoverable gas, that is given major weight.

Instead of figuring individual lives, I went to the group or composite basis. I tried to illustrate to you that we find the physical lives of pipe line to be very, very long, but we are not able to use those lives in a calculation of depreciation, because the economic life is much shorter. That has been true in practically every case we have had so far.

Q. Now, that feature, a discrepancy between a hypothetical physical life and an actual life has nothing whatever to do with compositing, has it?

The Witness: Read the question, please.

(The pending question, as above recorded, was read by the reporter.)

A. Well, you have got to determine the service life in order to make a theoretically correct composite estimate.

By Mr. Goodman:

Q. Well, is the composite, then, an inclusion of a hypothetical physical life along with consideration of an actual life? A. No. No.

Q. All right.

A. But in arriving at your depreciation rates, you are doing this according to the very fine calculations which we make, you must give consideration to the physical life in [fol. 9500] arriving at your over-all life.

If your physical life is shorter than the life of the natural resources, as it is in certain cases of plant, you have got to recognize that shorter life, of course.

[fol. 9507] Q. So that the consideration of life that you gave was something consistent with or comporting with 25 years; is that right?

A. I didn't give any real consideration to life estimates myself. I say again I took the company's result and I put it down as a percent to plant, and I find that that percent, in my opinion, is within the realm of reasonableness, based upon the experience and tests which I have indicated I have made. When you try to transpose that,

into a life of a field, I say that transposition would indicate somewhere around 35 or 36 years.

Q. All right.

Now, will you tell me how your answer that it would [fol. 9508] not be necessary to transpose that into a life harmonizes with your conception that depreciation is the proportion of service life or is based upon the proportion of service life which has expired?

A. I stated I thought the company had made such studies as would indicate the proper amount.

It had made a conscientious attempt to determine the reasonable depreciation. I think the estimate is slightly on the high side. The company has made a conscientious attempt, and from tests I have made, it appears reasonable.

Mr. Goodman, if we are going into a comprehensive depreciation study taking about a year, we are going to make a detailed study of each class of property, we are going to arrive at a composite amount, or we might apply rates to individual pieces of property. Instead of around 3 percent, it might come out to 2.85, 2.90, 2.75. Those changes will always be made, and we reserve the right, when we make a detailed study, but I am trying to tell you that I have tested the company's over all results.

I have indicated the tests I have made and I am convinced that they are within the realm of reasonableness.

[fol. 9510] Q. So that you think it would be fair in this particular case to use an over-all life of 35 years?

A. No, I would say it is fair in this case to use the company's estimates. After all, depreciation is an estimate. As to whether an item will last 35, 36, or 37 years involves, to a certain extent, speculation, and you can't indicate the [fol. 9511] life of a piece of property or the life of a natural resource with precision any more than you can guess the life of human beings with precision.

I repeat my statement that the tests we made, which were comprehensive tests, indicate that the over-all rate

is reasonable, and I think the company has done a more conscientious job than most companies in computing their depreciation expense.

Trial Examiner: By the way, Mr. Smith, this is, in practice, essentially a straight line method of depreciation, is it not?

The Witness: Yes, I would say that.

By Mr. Goodman:

Q. All right.

Now, will you tell me, Mr. Smith—we have covered the element of service life. Now, will you tell me what other factor the company has used in ascertaining depreciation so as to reach what you say is a conscientious conclusion?

A. Well, I tested it by the over-all amount, and that was my basis.

Q. Well, will you proceed to state the method that you applied in estimating?

A. Yes. I compared the over-all rates with the over-all rates which we worked out in other cases, and which many other companies are taking.

[fol. 9512] Q. Now, what was the basis of your comparison? A. Over-all amount.

Q. In terms of percentage? A. Yes.

Q. What percentage? A. Percentage to plant.

Q. I beg pardon? A. Percentage to plant.

Q. Well, what percentage did you use?

A. The company is using about 3 percent.

I didn't use any percentage, I tested the company's amount.

Q. Well, you tested the company's amount of 3 percent—is that right? A. Yes, sir.

Q. And you concluded that 3 percent was reasonable—is that right? A. Yes, sir, that is right.

Q. Now, what do you find about 3 percent which endows it with the attribute of conscientiousness?

A. Well, you are talking about two different matters now.

I find nothing in the three percent itself which endows it with anything. I have studied the minutes of the com-

pany, and I have talked to my staff, too, who investigated the company's books and documents. I have studied [fol. 9513] the testimony that certain men of the company's have given before the S. E. C., and I will say to you the company has made a conscientious attempt to solve this problem.

Q. What are the basic elements of this conscientious attempt?

A. The Board of Directors discussed the matter and the Board of Directors had an independent engineer give his opinion, and they also had other men—geologists—give estimates of reserves.

They have taken these things into consideration in trying to arrive at the proper amount.

Now, that is far better than that of a good many companies which have some one individual just call an amount which they put down often—too often, as a matter of fact,—an amount which is related to the profits and not to the properties.

I said this company got off to a good start and did a good job.

[fol. 9514] Q. How do you know that it is conscientious?

A. I know it is conscientious because I interpret the record as showing that it was a conscientious attempt and because the results the company arrived at looked very reasonable to me.

And I say to you: compared to many other companies, the company is far ahead of its time.

Q. Well, can you show me any principles which indicate conscientiousness?

A. Well, I think I have already mentioned them.

Q. Well, you mentioned the appointment of an engineer.

A. The company started off in the first instance with a determination of service lives. Then it employed an engineer and employed geologists and had a good deal of information as to what was the probable amount of depreciation, depreciation being an estimate, and the amount it arrived at is a very reasonable figure.

Probably the company has been a little conservative in taking too much, slightly on the high side, not much, but a [fol. 9515] little conservative.

It is not a bad thing in the extractive industry, but I say to you that the record I have studied indicates that the company has done a conscientious job. I have enumerated, I believe, Mr. Goodman, the elements that—

Q. (Interposing) Now, let's see. In the first place, you have not given me any service life as a basis for this conscientious job, though you started your testimony by saying that depreciation and its calculation was always referable to a service life.

[fol. 9516] I am not so sure I started my testimony out in the manner you indicated.

I said that depreciation was the consumption of economic life, and certainly the company has made an attempt to determine that and has so recorded amounts in its books and has published the amounts in its statements.

Q. All right.

Mr. Smith, what economic life, then, did the company use?

A. The company considered that the investment in its properties would come to an end and that it would have to amortize that investment, if amortized at all, during the life of the property.

It started out, first, by making fine calculations as to each class of property. They later changed to an over-all basis, which I said approximates 33 years.

A. Generally speaking the company determined at the present time that somewhat more than a 33-year life is a [fol. 9517] reasonable life of the property.

Mr. Littman: Over-all life?

The Witness: Over-all from the beginning.

By Mr. Goodman:

Q. Is that the reason why you consider it a conscientious job?

A. No. I consider it a conscientious job because of the evidence that the company tried to find the right figure. I don't think for a moment in arriving at that evidence the company has to make the fine calculations as to each item of property every year. Theoretically, that has to be done, but you have got to—practically, it can't be done.

Q. I didn't ask you that.

A. Your question clearly implies that, Mr. Goodman.

Q. I ask you this: Do you consider that the over-all life of somewhat in excess of 33 years, which you say was used and applied by the company, stamps this, the determination of depreciation, as a conscientious job?

A. Well, the result, I think, indicates that it is reasonable. A company could get a result by being conscientious or not being conscientious, but I think in this case it has been conscientious in arriving at that result.

[fol. 9533] The important thing to do in this depreciation matter is to try and fix depreciation expense as accurately as you can.

If you fix too low a rate you are simply bringing disaster upon the company, and if you bring disaster upon the company you bring disaster upon yourself. You can't fix too low a rate.

The next important thing is that the amount you allow as depreciation expense be deducted in computing the rate base. Those are the first two fundamental principles of public utility depreciation or regulatory depreciation.

Q. Well, you wouldn't think that there would be much harm, then, in fixing too high a rate of depreciation?

A. I would say this: rather than be too low I would rather be too high in the annual allowance, because I agree with the Supreme Court's statement that the detriment to the public, in causing a company to go under, will far outweigh any temporary lowering of rates.

In other words, protection of the company is a protection of the public interest, and that protection requires that depreciation expense be adequate.

[fol. 9538] By Mr. Goodman:

Q. Now, Mr. Smith, will you come down and tell me when, in reference to the hypothetical question that I asked you, you would recommend that the price of service be changed?

A. I think—of course, we are now getting into the realm of theory in the change of rates—I think that if at all possible, we should fix rates for a period of at least two years, a period of five years being desirable, if you can [fol. 9539] possibly do it. In some cases, you cannot do it very well but a period of two years, I would say, should be the minimum unless you are able to put in a sliding scale arrangement such as we have in the District of Columbia where rates are subject to change annually but, ignoring for the moment the sliding scale arrangement, I think you ought to try to fix the rates for a couple of years and that means you have got to take into consideration the plant additions in the couple of years, the increase in depreciation reserve, changes in the economic conditions and matters of that kind.

[fol. 9567] Trial Examiner: Mr. Smith, if you have some summary to add to this long examination, will you please do so?

[fol. 9568] The Witness: Mr. Examiner, I believe I have indicated this morning that the subject of depreciation is a very broad subject. We have not reached the development in the science of depreciation where we can say one method and only one method is right. We have reached the point where we recognize merit in several methods.

I would like my testimony to stand that I have examined the Company's method and the Company's amounts and, based upon my experience and the tests which I have made, I think they are reasonable and I think the depreciation expense they have recorded on their books and the depreciation reserves they have set up should be used as the

proper expense in this proceeding and as the accrued depreciation, respectively.

[fol. 957g] EDWARD L. DUNN a witness called by and on behalf of the Commission, having been first duly sworn, was examined and testified as follows:

Direct Examination.

By Mr. Littman:

Q. Will you state your name and address?

A. Edward L. Dunn, 504 Bashford Lane, Alexandria, Virginia.

Q. What is your present position and how long have you held it?

A. I am an accountant with the Federal Power Commission, entitled chief examiner of accounts. I have been with the Power Commission since 1934, except for a short period of time.

Q. Will you describe briefly your education and experience?

A. Upon graduation from high school in 1924, I entered Missouri University, where I took the first year in Engineering School. I attended Penn State for the second and third years, taking mainly engineering subjects.

In 1929 I was employed by Eaciede Christy Clay Products Company, St. Louis, Missouri, as an assistant to the industrial engineer. I was transferred to the general offices to learn cost accounting, became interested in accounting, and completed the course in Higher Accountancy of LaSalle Extension University. I also later took a graduate course in Accounting and Finance at Columbia University, New York City.

When it became apparent that the Federal Power Commission would have considerable accounting work relating to natural gas companies, I took a course in natural gas prepared by the University of Kansas, of which I have completed about two-thirds.

My experience has been practically entirely in bookkeeping, auditing, and accounting.

The three years I have spent in the accounting department of Laclede-Christy involved assignments to every bookkeeping and accounting job in the office below the grade of head bookkeeper.

In 1934 I entered the employ of the Federal Power Commission assigned to the Accounting Division. My duties related to accounting work incident to the determination of actual legitimate cost of licensed hydroelectric plants. (fol. 9572) most of the time being engaged in field examinations of the accounts of public utility corporations and assisting in preparing accounting reports thereon.

In 1936 I accepted a position in the comptroller's office, National Lead Company, New York City. My assignments included the accounting work in revising and restating the depreciation expense and depreciation reserves of all the branches and affiliated companies. I also made internal audits, several cost studies used as the basis of large contracts, and certain proceedings before Government bureaus.

I returned to the Federal Power Commission in 1937. Since then I have made many accounting investigations, several of them being rate cases, both electric and natural gas.

In each case I devoted particular attention to the depreciation and depletion phase of the examination. The depreciation report on one electric case, where I worked under the direct supervision of Mr. C. W. Smith, Chief of the Bureau of Accounts, Finance and Rates, included a comparison and study of depreciation methods and our report has been widely circulated among those interested in the subject.

My natural gas rate case assignments have been an examination and report on original cost of plant accounts, depreciation and depletion of New York State Natural Gas Corporation and Examiner in Charge of the accounting examination of Canadian River Gas Company, Colorado Interstate Gas Company and Colorado-Wyoming Gas Company (fol. 9573) and Hope Natural Gas Company.

Some of the electric utilities where I made rate investigations were Philadelphia Electric Company, Safe

Harbor Water Power Corporation, and Interstate Power Company.

Q. Have you visited the office of Panhandle Eastern Pipe Line Company in connection with the present rate case?

A. I have on two occasions, the first visit covering a period of ten days spent in Kansas City, Missouri, during the last part of September, 1941, and the second trip covering a period of ten days in Kansas City and Chicago during March, 1942. I also spent several days in the offices of Michigan Gas Transmission Corporation in Detroit, Michigan, during February, 1942.

Q. Did you make an examination of the books and records of Panhandle Eastern Pipe Line Company and Michigan Gas Transmission Company?

A. I investigated several matters, quite a few matters, but I did not make an audit of the books, even in a limited manner. What I was particularly interested in was verifying the accounting policies of the companies, the manner in which the records were kept, the adequacy of the books and records, the principles followed, the system of accounts followed.

In other words, I wanted to know if the records accurately reflect the cost of plant and the cost of operations and if the detailed information was readily ascertainable from the books and records.

Q. What, in general, are your conclusions with respect to the accounting principles followed and the adequacy of the books and records of these companies?

A. The code of accounts followed by both companies prior to January 1, 1940, is substantially the same—

Q. (Interposing) May I interrupt there? You just referred to both companies. Which companies are you now speaking of?

A. Panhandle Eastern Pipe Line Company and Michigan Gas Transmission Corporation.

Q. And when you used the term Panhandle Eastern Pipe Line Company, you [include] its wholly-owned subsidiary, Illinois Natural Gas Company, do you not?

A. That is correct.

Q. Proceed, please.

A. I just said the code of accounts followed by these companies—

A. (Continuing) —was substantially the same in so far as accounting principles are concerned as the present F. P. C. uniform system of accounts. The books and records of the company are complete and the cost of plant and [fol. 957a] cost of operations may be readily ascertained from the accounts.

With the exception of the item of gas sales and purchase contracts, possibly the depletion and amortization of gas producing properties west of Liberal, and the original cost of certain properties known as local area operations, I do not believe that there are any substantial adjustments necessary in the accounts of the company.

Q. Do you propose an adjustment relating to "Gas Sales and Purchase Contracts" shown on page 2 of Exhibit 52 and at page 2 of Exhibit 176, line 40, and "Reserve for Amortization of Gas Sales and Purchase Contracts" shown in Exhibit 52 line 42?

A. Yes, and it follows from the adjustment that I propose that the annual amortization of the item appearing in the income statement, Exhibits 49 and 173, on line 15 "Amortization of Other Limited Term Gas Investments" will be adjusted also.

Q. What is your proposed adjustment of the item "Gas Sales and Purchase Contracts" and will you please state, as you describe your proposed adjustment, the necessary references to the exhibits which show this item?

A. Well, I am now referring to Exhibit 176, lines 40 and 42. The necessary adjustment—

Q. (Interposing) That is on page 2, isn't it? [fol. 957b] A. Page 2.

A. The necessary adjustment is to eliminate the net amount of \$1,172,114.80 from the gas plant accounts as at December 31, 1941. This net amount is the difference between \$2,930,286.40 shown in line 40 column M, and the \$1,758,171.60 shown on line 42, column M. Also it is necessary to eliminate the annual amortization appearing in

line 15, column M of Exhibit 173 in the amount of \$293,028.60.

Q. Now, the reference to Line 15, column M of Exhibit 173, was to the second page? A. No.

Q. Was to the first page of that exhibit; was it not?

A. That is correct.

By Mr. Littman:

Q. Why, in your opinion, is it necessary to eliminate [fol. 9577] these amounts?

A. The remaining unamortized amount of \$1,172,114.80 contains no element of actual cost. It represents a write-up. The contracts are recorded on the books merely as a valuation and do not purport to represent anything more than a valuation. The basis for the valuation is clearly disclosed in the entry recording on the books of Panhandle Eastern the original amount of 2,398,402.49—

Q. (Interposing) Dollars?

A. Dollars. (Continuing). — for purchase and sales contracts.

This entry is designated voucher J2, dated September, 1930.

I have before me a photostat of the voucher furnished by the company. It shows that the entry was made to record certain items acquired from Missouri-Kansas Pipe Line Company as per a contract dated September 17, 1930, and a supplemental agreement dated October 23, 1930; an amount of \$4,816,350.17 was charged to Fixed Capital and the entry was approved by the Board of Directors of Panhandle Eastern at a meeting held February 3, 1931, as follows—

Q. (Interposing) Before you read from the minutes of that meeting, I would like to have you state the names of the parties to the agreement of September 17, 1930, to which you made reference a moment ago.

[fol. 9578] A. The parties to that agreement were the National City Company, Missouri-Kansas Pipe Line Company, and Columbia Gas and Oil Corporation.

Q. Oil and Gasoline.

A. Columbia Oil and Gasoline Corporation.

Q. Do you have before you a copy of pertinent excerpts from the minutes of the meeting of the Board of Directors of Panhandle Eastern held February 3, 1941, relating to these gas sales and purchase contracts?

A. Yes, I have an excerpt from the minutes furnished by the company and also the copy of the minutes which was attached to and made a part of the voucher recording this item.

Mr. Littman: That should be February 3, 1931. I am sorry, Mr. Wheat.

By Mr. Littman:

Q. Had you completed your answer to my question?

A. I intended to read the minutes of the Directors relating to this item.

Q. Very well. A. The Chairman stated

[Vol. 9579] Q. These are in quotes, aren't they?

A. These are quotes.

The Chairman stated that on October 23, 1939, the Company had acquired from Missouri-Kansas Pipe Line Company, without cost to the Company, certain physical property, gas purchase and sale contracts, stocks of subsidiary companies, supplies, accounts receivable from subsidiary companies, and prepaid accounts, subject to the assumption of accrued taxes and deferred liabilities on the Jacksonville property. He stated that it was desirable for the Board to place a valuation on the property so acquired, to guide the Treasurer in setting up the acquisition on the books. He submitted a proposed valuation prepared by the Treasury Department, and explained in detail how the valuation was arrived at. Said proposed valuation was as follows:

Property, Plant, and Equipment, \$2,197,475.40.

Purchase and Sale Contracts, \$2,398,402.19.

Total Property, plant and equipment, \$4,595,877.59.

Construction Work in progress, \$220,473.12.

Total Fixed Capital, \$4,816,350.71."

Q. End quote.

A. End quote. The balance of the tabulation contained in the minutes refers to investments in affiliated companies.

and intercompany accounts which I don't feel it is necessary to read at this time.

[fol. 9589] Q. Very well.

Does Exhibit No. 176 show an amount of \$13,398,402.19 for the year 1930 in line 40, Column B?

A. That is correct.

Q. Of course, for this item of gas sales and purchase contracts?

A. That is correct; it does. In that year, the totals of gas sales and purchase contracts were recorded in the amount of \$13,398,402.19, which is exactly \$11,000,000 more than the amount of \$2,398,402.19 recorded by voucher J2.

Q. How did that come about and what does the \$11,000,000 represent?

A. The amount of \$11,000,000 is largely a write-up based on a valuation prepared by Messrs. Brokaw, Dixon, Garner & McKee, geologists and petroleum engineers, and approved by the Board of Directors of Panhandle Eastern Pipe Line Company at a meeting held September 3, 1930. The valuation is in substance as follows: I am reading from the minutes of that meeting:

"Based on our examination of the leaseholds for natural gas acreage, survey of the natural gas transmission line now under construction from the Panhandle Area of Texas, Oklahoma, and Kansas to Indiana, survey of the markets of the present non-competitive territory to be served by this line, analysis of the contracts signed and under negotiation for gas and of contracts available, we are of the opinion that such present and available sales contracts are of a present fair market value in excess of \$11,000,000."

Q. I note that in 1932 the amount shown in Exhibit 176, page 2, line 40, column D, shrunk from \$13,409,544.31 in the previous year to \$3,053,391.53. Will you tell us what happened to the \$11,000,000?

A. It was removed from the records of the company by resolution of the Board of Directors of Panhandle Eastern adopted at a meeting held March 29, 1932. Of the \$11,000,000, the amount of \$642,286.30 purports to represent cost and therefore the difference in the amount of \$10,357,713.70

was removed, by reversing the previous entry which recorded the valuation. The minutes read as follows:

"Reduction in Valuation of Gas Sale and Purchase Contracts."

"The Chairman stated that on September 3, 1930, the Board of Directors of this Company, pursuant to an appraisal by Brokaw, Dixon, Garner & McKee, had determined the value of the gas sales and purchase contracts owned by this Company to be \$11,000,000 and that an entry had accordingly been made on the books of account of the Company charging 'Gas Sales and Purchase Contracts' and crediting 'Surplus—Valuation of Gas Contracts' with the sum of \$10,357,713.70, being the difference between the [fol. 9582] value so determined and the amount already carried on the books. He recommended that this entry be now reversed, and explained to the Board the reasons for this recommendation, stating that it was approved by the Company's counsel and auditors. After discussion, of motion duly made and seconded, the following preamble and resolutions were unanimously adopted:

"Whereas the Board of Directors of Panhandle Eastern Pipe Line Company, at its meeting held September 3, 1930, pursuant to an appraisal by Brokaw, Dixon, Garner & McKee, adopted a resolution determining the value of the gas sales and purchase contracts owned by this Company to be \$11,000,000 and ordered the value of said contracts to be so entered on the books of the Company;

"Whereas pursuant to said resolution an entry was made on the books of the company charging gas sales—

Q. You mean on the books of accounts of the company.

A. —books of accounts of the company charging 'Gas Sales and Purchase Contracts' and crediting 'Surplus—Valuation of Gas Contracts' with the sum of \$10,357,713.70; and

"Whereas in the opinion of this Board, it is desirable to reverse said entry in order that the books of account of this company shall be as fully as possible in accord with sound and conservative accounting practice;

[fol. 9583] "Now, Therefore, Be It Resolved that the Treasurer of Panhandle Eastern Pipe Line Company be

and hereby is directed to enter on the books of account of the Company a credit of \$10,357,713.70 to the account entitled 'Gas Sales and Purchase Contracts' and a debit in the same amount to the account entitled 'Surplus—Valuation of Gas Contracts'; and

Resolved that the Treasurer of the said Company be and hereby is directed to investigate and report to this Board his recommendations with respect to the balance remaining in said account 'Gas Sales and Purchase Contracts' after the entry of the credit hereinabove ordered."

Q. Do I correctly understand that the amount of \$3,053,391.53, which appears on page 2 of Exhibit 176, Column D, is composed of two distinct items?

A. Yes. The amount of \$642,286.30 plus expenses of \$12,703.04 incurred in 1931 and 1932, or a total of \$654,989.34 and the amount of \$2,398,402.19 recorded by voucher 42. In 1936 the balance in the reserve at December 31, 1935, shown in Line 42, Column G, in the amount of \$123,195.13 was applied to the asset account resulting in the net amount of \$2,930,286.40 shown in Line 40 for the year 1936 and subsequent years. The remaining amount of \$2,930,286.40 is being amortized at the rate of 10 percent per year. This 10 percent rate of amortization began in [Feb. 1934] 1936 and the gross amount would be fully amortized at the end of 1945.

Q. In other words, as I understand your testimony, the Panhandle Eastern Pipe Line Company and Illinois Natural Gas Company are charging annually to expenses at the present time the sum of \$293,028 per year for the purpose of amortizing this item of gas sales and purchase contracts to which you just made reference?

A. That is correct, they are.

Q. Now, referring to the amount of \$2,398,402.19, which you stated was a "write-up," please state what investigation you have made concerning the item.

A. Since the account was transferred from Moka-

Q. (Interposing) By "Moka" you refer to Missouri Kansas Pipe Line Company, do you not?

A. That is correct.

A. (Continuing) —the parent company of Panhandle Eastern, obviously the first step was to determine what Mokan had recorded in its accounts and the cost, if any, to Mokan. Panhandle Eastern did not have the Mokan records, which are, at present, in the offices of a law firm in Chicago. I examined these records and noted that Mokan had recorded an amount of \$1,106,250 in the account Gas Sales and Purchase Contracts. The origin of this amount was the opening entry on the books of Mokan and the opening entry was again based on a valuation by Messrs. [fol. 9585] Brokaw, Dixon, Garner, and McKee.

Q. Before going into that valuation, am I correct in understanding that by reason of the transaction involving the transfer of properties from Mokan to Panhandle Eastern, the account denominated "Gas Sales and Purchase Contracts" was increased from \$1,106,250; the last balance of the account shown on Mokan's books, to \$2,398,402.19, the opening balance shown on Panhandle Eastern's books?

A. That is correct.

Mr. Culton: May I ask a clarifying question there?

● Mr. Litman: Yes, sir.

● Mr. Culton: Did you find any identification on the records of Mokan from which you could identify the contracts there valued as being the contracts entered on the Panhandle Eastern books?

The Witness: They did not list in their general ledger the details of just what contracts. It just said Gas Purchase contracts required.

Mr. Culton: Then, the answer is that there was no identification of what the contracts were which you found on the Mokan books?

The Witness: Well, for that identification, I relied on the description by Panhandle Eastern in which they said they had valued these contracts acquired from Mokan and Mokan was turning over all gas purchase contracts [fol. 9586] it had to Panhandle Eastern which, with the exception of the Kentucky properties—anything relating to their Kentucky properties.

Mr. Culton: I understand that you did not have any discussion with any of the Panhandle Eastern accountants

indicating that they had any familiarity with what is shown on Mokan's books?

The Witness: I, of course, asked them, but they did not know exactly what was on Mokan's books. They had a fair idea what was on there.

Mr. Culton: That was to see whether or not there was anything in the books themselves to describe the contracts and show that they were the same contracts. My understanding is that there is nothing in the Mokan books identifying what gas purchase contracts were included in the million dollars; that is correct, isn't it?

The Witness: Well, nothing except that Brokaw, Dixon, Garner, & McKee made a valuation of Mokan's contracts which would necessarily include all contracts.

Mr. Culton: What I meant to ask you: Do you have that valuation?

The Witness: No, I do not.

Mr. Culton: Did you see it?

The Witness: I saw many references made to it in the [fol. 9587] reports by the auditors of Mokan who were required to make several audits for various reasons, some of which were denoted stipulated audits and they always referred to these contracts as a valuation basis made by this—

Mr. Culton: (Interposing) Mr. Dunn, I just have one question and probably I am not making myself clear: I want to know if you found on the Mokan books or on any Brokaw, Dixon, Garner & McKee report which you found, an identification of the gas sales and purchase contracts that were either valued by Dixon—Brokaw, Dixon—or put on the books of Mokan, so that we can say between whom the contracts were or anything of that character.

The Witness: Oh, no individual contracts, just all contracts, but no breakdown as to what—

Mr. Culton: (Interposing) No identification of any character except just all contracts?

The Witness: That is right.

Mr. Culton: That is all. Thank you.

By Mr. Littman:

Q. Well, Panhandle Eastern acquired all of the contracts that Mokan had at the time of the transaction, which you just described; did it not?

A. That is my understanding of it, except possibly some contracts that might relate to what they call their Kentucky properties.

[fol. 9588] By Mr. Littman:

Q. You have just testified that the transaction involving the transfer of properties from Mokan to Panhandle Eastern—that is, by reason of that transaction, the account denominated "Gas Sales and Purchase Contracts" was increased from \$1,106,250 to \$2,398,402.19?

A. Yes.

Q. Is that right?

A. Those contracts transferred from Mokan to Panhandle Eastern were increased that much.

Q. Now, there alone is a write-up of at least \$1,292,152.19; is that correct?

A. Yes, plus an amount of \$180,000 appearing in Capital Surplus account of Mokan as a credit offset to the recorded value of gas contracts. When Mokan closed the accounts transferred to Panhandle Eastern, it also closed this surplus account, then called "revaluation surplus", thereby reducing the recorded value of gas contracts, and the write-up becomes \$1,472,152.19.

Q. Did any portion of the \$1,106,250, shown on Moka's books for these gas sales and purchase contracts, represent cost?

[fol. 9589] A. Not more than \$1,250 represents valid cost. The balance of \$1,105,000 was recorded by the opening entry on Moka records, Voucher-F1, June 1, 1930. This entry purported to record the value of properties acquired from Shippey, Maddin, and Parish Gas Company, a partnership. The partners formed Moka and transferred the partnership properties and contracts to the corporation. The total of the assets acquired by Moka were carried on the partnership records at the amount of \$413,047.28 and were recorded by Moka in the amount of \$630,000. Thus Moka entered the amount of \$1,735,

1000 as fixed capital. The valuation of Gas Sales and Purchase Contracts was 100 percent write-up on Moka books, and was never claimed to represent other than a write-up by any of the Moka, Panhandle Eastern, or Columbia interests.

Q. Did you request Panhandle Eastern to furnish all support that they had for the cost or other basis of valuation for this item of "Gas Sales and Purchase Contracts"?

A. Yes, it furnished the vouchers and minutes referred to. There was considerable information concerning the item in their files relating to Federal Income Tax Returns. The company furnished me with copies of the Internal Revenue Agent's investigation and reports on the item and correspondence pertaining thereto. They present a rather complete picture of the gas sales and purchase contracts.

Mr. Littman: Mr. Examiner, I would like to have marked [fol. 9590] for identification with the next Exhibit number a document entitled "Panhandle Eastern Pipe Line Company Gas Sales and Purchase Contracts, copy of report by Bureau of Internal Revenue and related correspondence."

Trial Examiner: It will be marked for identification as Exhibit 219.

[fol. 9592] By Mr. Littman:

Q. Referring to the investigation made by the Bureau of Internal Revenue, with respect to this item of gas sales and purchase contracts, what conclusion is reached therein? and please make reference to Exhibit No. 219 in answering.

A. The item was disallowed—the amortization of the item was disallowed—because it was—

Q. (Interposing) By "disallowed," you mean it was claimed for federal income tax purposes—

A. (Interposing) That is right: claimed as an operating expense of the company, as a deduction for tax purposes.

Q. (Continuing) —and the Bureau of Internal Revenue [fol. 9593] disallowed it? A. That is correct.

Mr. Wheat: In order that the record may be perfectly clear, I wonder, Mr. Dunn, whether it wouldn't be advisable for you to state what the claim for deduction was, and what

was the ruling, or tell us where it appears in this voluminous document.

The Witness: I will.

Mr. Wheat: Do you mind, Mr. Littman?

Mr. Littman: Not at all, Mr. Wheat, and I believe, if you will just be patient with us for a moment, we will reach all those points shortly.

Mr. Wheat: All right.

By Mr. Littman:

Q. Now, you were saying that the item was disallowed. Now, do you want to particularize with respect to that?

A. Yes. The amortization of the item was disallowed because it was without recoverable basis.

The report recognizes the principle that, if the transferor had a recoverable basis, then the taxpayer has a taxable basis to be recovered.

The exhibits attached to the report disclose that there was no cost or other taxable basis for the gas sales and purchase contracts.

The explanation appearing in the report is on Page 4 of [fol. 9594] this exhibit.

Q. Perhaps it would be well to read the explanation of items shown on that page.

Mr. Littman: Those explanations are not lengthy, and they might serve here to clarify the transcript.

A. Well, the agent first makes a preliminary statement, which appears on Page 3, wherein he says:

"The principal causes of the change in tax liability are the disallowance of amortization of gas sales and purchase contracts acquired from predecessor company without recoverable basis—"

From there on—

Mr. Wheat (interposing): I wonder if you would mind telling us what that means. You have used that phrase "without recoverable basis." Just so the record will be clear.

The Witness: Yes. He is referring to the Federal Revenue Act of 1928, which covers depreciation and depletion matters.

In general "recoverable" means a cost basis.

Mr. Wheat: I see.

The Witness: Prior to 1913 the recoverable basis was fair value or cost, whichever was higher, but clearly this falls within the cost section of the law.

[fol. 9595] Mr. Wheat: Thank you.

By Mr. Littman:

Q. You have read the pertinent part of the preliminary statement on Page 3, have you not?

A. That is correct.

Q. All right. Will you go to page 4?

A. There is one other point that I might mention that might be of interest here.

Q. Very well.

A. The agent further states:

"The changes were discussed with Leith V. Watkins, secretary; N. F. Paxton, assistant secretary; and Arthur Anderson & Company, accountants. Form 874 has been executed."

This form 874 referred to is a form 51 waiver executed by the company, agreeing to these changes, and it is attached as a part of this exhibit.

Q. Will you give us the page on which the said form 874 appears in Exhibit 219?

A. That appears on Page 11. Immediately preceding this form is a letter from Mr. Watkins, explaining why the Board of Directors had agreed to the findings of the Bureau of Internal Revenue.

Q. Now, that letter is dated November 7, 1941, and was addressed to Mr. N. F. Paxton, assistant Secretary of Pan-
[fol. 9596] handle Eastern Pipe Line Company: is that correct? A. That is correct.

[fol. 20]. By Mr. Littman:

Q. Yes. You were going to go back to the agent's report.

Where do you propose now to read?

A. On Page 4. Explanation of items.

Q. On Exhibit 219? A. That is right.

In original Revenue Agent's reports for 1936, 1937, 1938 and 1939, an amortization of the book value of gas purchase and sales contracts computed on a composite life of 20 years was allowed in computing the taxable income subject to approval and verification by the Valuation Section of the Internal Revenue Bureau in Washington.

It has since been disclosed that this book value exceeded the taxable basis recoverable by \$2,398,402.19, which is the value at which a portion of the contracts were received from the Missouri Kansas Pipe Line Company in October, 1930.

The latter company at that time owned all the stock of Panhandle Eastern Pipe Line Company, and as provided in Section 118 (a) (8) of the Revenue Act of 1928 the taxpayer has a taxable basis to be recovered the same as in the hands of the transferor.

Further investigation discloses that these contracts were acquired for stock from a partnership, Shippey, Maddin and Parish Gas Company, which at that time in 1928 [fol. 9600] owned all of the Missouri Kansas Pipe Line.

Mr. Wheat: All of the what?

Mr. Littman: All the stock.

A. All of the stock of the Missouri Kansas Pipe Line. It has been also disclosed that the partnership had no cost in acquiring the contracts and reported no taxable profit on the transfer of the contracts to the corporation for stock. See Exhibits B and B(1).

By Mr. Littman:

Q. Now, have you attached Exhibits B and B(1) to which reference is made in the agent's report? A. Yes.

Q. Where do those appear?

A. Reference should be made to Exhibit A, B, and B(1) in this connection.

I want to continue some more from the agent's statement.

Q. Very well.

A. "Under the circumstance described, the amortization allowed—"

Q. (Interposing) Pardon me? Where are you reading now? A. Page 5.

Q. Very well.

A. (Continuing) "—the amortization allowed on the [fol. 9601] book value set up on the contracts received from the Missouri-Kansas Pipe Line Company in the original report is being eliminated."

"Book value of contracts received from Missouri-Kansas Pipe Line Company on October 23, 1930—\$2,398,402.19.

"Amortization allowed at five per cent on above amount in original report eliminated—\$119,920.11."

Q. Mr. Dunn, is my understanding correct that, for income tax purposes, the Panhandle Eastern claim for amortization of gas sales and purchase contracts was at the rate of five per cent each year? A. That is correct.

Q. Commencing in 1936?

A. Well, he commenced in 1936, because that was the first taxable year that the agents made an investigation.

Q. Yes; now, for the purposes of this proceeding, and for purposes of Panhandle Eastern's own bookkeeping, they amortize at the rate of ten per cent per year, do they not?

A. They are, beginning in 1936. Prior to that they used a slightly different rate.

Q. And as you have heretofore explained, they are currently amortizing the amount and if amortization were to continue at the rate of ten per cent per year the account would be fully amortized at the end of 1945?

A. That is correct.

[fol. 9602] Q. However, as I understand this, the entire claim by the company, of amortization of this item for income tax purpose, was disallowed by the Bureau of Internal Revenue, was it not?

A. Yes; after they made a reexamination they came to the conclusion that there was no recoverable basis, and by that they mean no actual cost pertaining to these gas sales and purchase contracts.

[fol. 9603] By Mr. Littman:

Q. Mr. Dunn, you were about to explain Exhibit "A" of the Internal Revenue Bureau's report which appears at page 6 of Exhibit No. 219. Will you proceed with your explanation?

A. Yes. As shown by this tabulation, the Bureau of Internal Revenue had knowledge of the costs from the income tax returns reported by Missouri-Kansas Pipe Line Company and, near the bottom of the page, the last item, "Value of Gas Purchase and Sales Contracts", the cost, as reported by Missouri-Kansas Pipe Line Company, is shown as \$926,250. Opposite that is a column headed, "Taken Up By Panhandle Eastern" shows an amount of \$2,398,402.19 or an increase in this item of \$1,472,152.19 and that amount checks with the amount that I found by an inspection of Moka records.

Q. By an inspection of Moka records and also by the record of Panhandle Eastern? A. That is right.

Q. Will you now turn to page 7 of Exhibit No. 219 and explain that schedule?

A. The Bureau of Internal Revenue had a record of cost to a partnership known as Shippey, Maddin and Parish Gas Company and, under Footnote (a), there is shown as cost to Shippey, Maddin and Parish, the amount of \$413,047.28 which is the amount of the property that Shippey, Maddin and Parish had at the time these partnership assets were transferred to Moka.

[fol. 9604] Q. You mean property as distinguished from gas sales and purchase contracts?

A. All the cost of property. That is all they had in total dollars, \$413,047.28. Now, Missouri-Kansas Pipe Line Company recorded that on their books in the amount of \$630,000 and, in addition, recorded the amount of \$1,472,152.19 as a value for gas purchase and sales contracts. Therefore, clearly, all of the gas purchase and sales contracts represented no cost to the partnership.

Q. Do you have any further references to make to the report of the Bureau of Internal Revenue for the purpose of explanation?

A. Exhibit "B-1", which has been referred to, explains the circumstances under which these properties were sold by Shippey, Maddin and Parish and acquired by Moka.

Q. That appears on page 8 of Exhibit No. 219, does it not?

A. That is correct. That is all I have to say in explanation of the report by the agent of the Bureau of Internal Revenue.

Q. Now, will you proceed to explain the remaining subject matter in Exhibit No 219, confining your description to such matters that relate to the matter of gas sales and purchase contracts.

[fol. 9605] A. On page 13 is shown a letter dated April 11, 1940, from the Chief Counsel of the Bureau of Internal Revenue and there is a reply thereto dated August 21, 1940, with a list of attachments. This letter is signed by Mr. Leith V. Watkins, Secretary-Controller.

Q. In response to the letter addressed to Panhandle Eastern Pipe Line Company by Mr. J. P. Wenchel, Chief Counsel of the Bureau of Internal Revenue, is that right?

A. That is correct.

In these letters, the Bureau requested detailed information in regard to each gas purchase and gas sale contract. The information was furnished as shown by the details attached to the letter of transmittal dated August 21, 1940. The summary sheet of gas purchase contracts showed that they were acquired from Mōkan without cash consideration. The summary sheet is shown on page 17.

I omitted the list of contracts because it involved 18 pages.

Q. Those are the gas purchase contracts?

A. I omitted the entire list of gas purchase contracts. There were numerous contracts.

Page 18 is a summary sheet for gas sale contracts. They are also shown to have been acquired from Mōkan without cash consideration. Following this sheet, there are shown the original contracts. I note under the column headed, "Duration of contract", that these original contracts [fol. 9606] have now expired.

I might add that the list of contracts contains all other contracts besides the ones acquired from Mōkan.

Q. How are the contracts which were acquired from Mōkan designated in the schedule which appears on pages 19 to 22 of Exhibit No. 219?

A. Referring to the summary sheet, page 18, Note (1) refers to the gas sales contracts which were acquired from Mokan and each contract, so acquired, is designated by the numeral (1) on the analysis sheets.

Q. Now, this summary shows the names of the contracting parties, the duration of contract, the territory covered, a brief statement of the terms of contract, the date acquired and from whom and the consideration, does it not?

A. It does.

Q. Do you have any further explanation to make with respect to Exhibit No. 219?

A. There is another letter dated October 3, 1940, from the Chief Counsel of the Bureau of Internal Revenue and the reply thereto dated February 24, 1941. This correspondence shows the history of the acquisition of the properties from Mokan very clearly in the first attachment. This is on pages 26, 27, 28 and 29.

Q. As I understand it, pages 26, 27, 28 and 29 contain Panhandle Eastern's own statement given to the Bureau of [fol. 9607] Internal Revenue respecting its understanding of the gas sales and purchase contracts?

A. That is correct.

Q. I note there is a final attachment on page 30, the last page of Exhibit No. 219. Do you have any comment to make with respect to that?

A. The second attachment, of course, relates to other gas sales and purchase contracts concerning which the company had stated the cost of acquisition of these contracts was not capitalized. The wording caused the Bureau of Internal Revenue to inquire into the matter and this is the answer which shows that Panhandle Eastern, of course, acquired many contracts through the services of its own employees without cost other than such incidental overhead costs and traveling expenses of its own employees. That probably explains why there is no capitalized cost for all other gas purchase contracts with the exception of such contracts that involve a payment for change-over costs and house heating costs. Change-over distribution system and house heating change-over costs, to a certain extent, have been capitalized by Panhandle Eastern.

Q. I take it you merely inserted page 30 for the purpose of making the excerpted portions complete because some

reference had been made in the correspondence which passed between the Bureau of Internal Revenue and Panhandle Eastern?

A. That is the reason it was included.

[fol.9608] (Exhibit No. 219 was received in evidence.)

Q. Mr. Dunn, during the course of your examination into the records of Panhandle Eastern Pipe Line Company, did you examine and read Minutes books of that company?

A. I did.

Q. Did you cause to be excerpted from those Minutes books portions of the Minutes of that company relating to depreciation? A. I did.

[fol.9609] Mr. Littman: I ask, Mr. Examiner, that a document entitled "Excerpts from Minutes of Meetings of Board of Directors Relating to Provisions for Depreciation, Depletion and Amortization", be marked for identification as Exhibit No. 220.

Trial Examiner: It will be so marked.

(The document referred to was marked Exhibit No. 220 for identification.)

Mr. Wheat: Mr. Littman, may I ask a question of the witness? Is the material contained in Exhibit No. 220 for identification, Mr. Dunn, material furnished to you by the Panhandle Eastern Pipe Line Company at your request?

The Witness: It is.

(Exhibit No. 220 was received in evidence.)

Q. Mr. Dunn, have you made an investigation of the records of Panhandle Eastern Pipe Line Company and Illinois Natural Gas Company in order to estimate the working capital requirements of those companies?

[fol.9610] A. Yes, including the working papers used by those companies in preparing the estimate of working capital appearing on transcript pages 455 to 473.

[fol. 9612] Q. Coming back to the subject of working capital, I believe you stated that you had examined also the working papers used by company Witness Sperry in connection with his testimony which appears on pages 455 to 473. That is his direct examination which appears at these pages of the transcript. A. I have.

Q. Have you read Mr. Sperry's definition of working capital which appears on page 455 of the transcript, a copy of which transcript I now hand you?

A. Yes, I have read his explanation of the term "working capital".

Q. Will you please read his definition of working capital and read the question that precedes it?

A. (Reading)

Q. What do you understand the term "working capital" to include?

A. I understand that term to include the materials and [fol. 9613] supplies necessary and requisite for the carrying on of current operations and current repairs and also cash balances sufficient in amount to enable the corporation to pay promptly its current operating expenses as they accrue; to provide for such prepayments as are necessary; to afford provision for reasonably to be expected contingencies and to make possible the continuous efficient operation of the corporation. This necessarily includes the meeting of such emergencies as they occur and the proper maintenance of current credit.

Q. Is that what you understand the term "working capital" to include?

A. It is, with the understanding that the working capital estimates to be used for rate making purposes, that is, the amount to be added to the plant and property accounts, should not be duplicated in the allowable plant accounts or operating expenses.

Q. Will you give us an example of how certain items of working capital might be included in plant account and thereby duplicated?

A. We have an excellent illustration in the case of Panhandle Eastern. The company has followed the accounting practice of including an amount in the cost of construction for gas used in blowing, testing and packing lines. In fact, the company has capitalized operating costs on the main line prior to April 1, 1932, by charging such costs to plant.

accounts and crediting the plant accounts with revenues [fol. 9614] from gas sales. In view of the fact that the original line pack is now included in plant accounts, any additional allowance for such line pack represents a duplication of the item.

Q. How much has the company actually included in its plant accounts for blowing, testing and packing lines?

A. Panhandle Eastern has furnished me a statement of the amount showing that \$122,824.36, representing 1,319,414 has been capitalized for gas used in construction. Some of this gas was undoubtedly blown to the air, but there is certainly an adequate amount capitalized to cover any required allowance for line pack.

Mr. Littman: I ask that the document entitled, "Panhandle Eastern Pipe Line Company and Subsidiary Company" consisting of five sheets, each of which contains a tabulation relating to the table on the first page which is called, "Computation of Working Capital Requirement" be marked for identification as Exhibit No. 221.

Trial Examiner: It will be so identified.

(The document referred to was marked Exhibit No. 221 for identification.)

By Mr. Littman:

Q. Will you please explain how certain items of working capital might be provided in the allowance of operating expenses? You have already given one example of how working capital may be provided for in an allowance of [fol. 9615] capital.

A. Yes. I might add that this exhibit which we have just distributed—

Q. (Interposing) You mean Exhibit No. 221?

A. Yes. Exhibit 221 shows the source of the amounts in M.C.F. of gas used in testing lines at the last page and at the footnote of the last preceding page.

Taxes—

Q. (Interposing) Before you go to taxes, is my understanding correct that the figures shown on the last page of Exhibit No. 221, "Gas used in construction of pipe line March 31, 1932, to December 31, 1941", were furnished to you by Panhandle Eastern?

A. That is correct, they were, and if you will refer to the preceding page, the gas used in testing lines for the year 1931 is shown and that information—

Q. (Interposing) You mean for the year—

A. (Continuing) 1931. That is on the preceding page.

Q. That is at the bottom of the page, yes.

A. That information was also furnished by the company.

Q. Very well. Now, the next subject which we wish to discuss has to do with your explanation of how certain items of working capital might be provided in the allowance of operating expenses.

A. Taxes offer the best illustration. For instance, [fol. 9616] Federal income taxes are paid in quarterly installments beginning March 15 following the taxable year. Thus, the company has the use of the money collected for tax purposes which are collected from the customers more than a year in advance. A study of the balance sheet account, accrued taxes, for the year 1941, shows that Panhandle Eastern had on hand at all times about \$3,000,000 for tax accruals. This summary of the account appears on the fourth page of Exhibit No. 221.

By Mr. Littman:

Q. Now, you were explaining the item of accrued taxes for the year 1941. Will you explain that tabulation which appears at the top of page 4?

A. There is shown, by months, for 1941—

Q. (Interposing) You mean you show the balance in the tax accrual account as at the beginning of the month and as at the end of the month?

A. Yes. The debits, in general, refer to the amounts when they are paid. The credits refer to the amounts which are concurrently charged to current operating costs and credited to this account. The balance at the end of the month shows that the company has accrued and included in current operating costs about \$3,000,000 or more [fol. 9617] at all times for taxes.

Q. Let's examine the extreme right-hand column headed "Balance End of Month" for each of the months in the year 1941. What was the lowest balance at the end of any month in that year?

A. January, 1941, showed a balance of \$2,654,689.71.

Q. And what was the largest amount?

A. The largest amount is in September which showed a balance of \$3,808,825.20.

Q. Are those balances sufficient for the purpose of providing sufficient cash working capital for the company, in your opinion?

A. This item of taxes which is currently provided for in operating expenses but not actually paid until many months later is contributed in the monthly collections from the gas consumers and they actually provide cash working capital many times the amount computed by Mr. Sperry.

Q. In other words, assuming that the Commission would and, of course, it shall make a proper and adequate allowance for income taxes, that allowance would be sufficient to take care of necessary cash working capital?

A. The allowance for income taxes and all other taxes, of course, property taxes particularly.

Q. However, you are making a certain allowance, are you, for cash working capital requirements notwithstanding that fact, in your estimate?

[fol. 9618] A. I have computed a separate amount without regard to this fact.

Q. Yes. We will come to that presently.

* Let's pass on then to the next item. Have you computed the working capital requirement based on the actual operations of Panhandle Eastern and Illinois Natural Gas Company for the year 1941?

A. I have, as shown on page 1 of Exhibit No. 221.

Q. That page contains the summary of your estimate?

A. That is correct.

Q. Will you please explain the first item shown thereon which is headed, "Total Operation and Maintenance—1941" and there is an overriding heading called, "Cash Working Capital". Please explain that item in its entirety.

A. Operation and maintenance expenses for the year 1941 amount to \$3,392,827.95. I have deducted gas purchase cost in the amount of \$1,180,918.

[fol. 9619] A. (Continuing) leaving the amount of \$2,211,909. I have allowed 45 days as representing an adequate and liberal period for the company to produce and transport the gas for which revenues are collected.

Q. In other words, you have assumed that at all times 45 days of operating expenses are tied up in the business?

A. That is correct, I have.

Q. Now, why do you exclude purchased gas? That is, why do you exclude purchase gas cost?

A. For the reason that the company pays for gas purchases about the same time of each month when it receives revenue from gas sales and there is no requirement for cash working capital for this item of expense.

Q. Have you a tabulation which shows that?

A. Yes, the company furnished me with the statement appearing on page 2 which shows the due and payment dates on major gas sales contracts listing all the important contracts, date due and the date when they received the money for them. At the bottom of the page is shown a statement, "Due and Payment Dates on Major Gas Purchase Contracts. Due Date, 25th of Month. Payments Usually Made from 19th to 21st."

Q. That latter refers, of course, to gas purchased in the preceding month? A. That is correct.

Q. Who is the largest consumer of Panhandle Eastern? [fol. 9620] A. Michigan Consolidated Gas Corporation is the largest ultimate customer; in volume, I suppose Michigan Gas Transmission Corporation, which transports that gas and receives the payment for Panhandle Eastern.

Q. Now, in that connection, when does Michigan Gas Transmission Corporation receive its payments or, I should say, receive the payments from Michigan Consolidated Gas Company?

A. I understand about the 23d to the 25th of the month.

Q. Let me ask you this, Mr. Dunn. What is the source of the information shown on page 2 of Exhibit No. 221?

A. That was furnished by the company and it answered all the questions in my mind concerning any possible lag between the receipt of revenues and the payments of gas purchase contract amounts.

[fol. 9621] Q. In other words, there was no lag?

A. No. There is a lot of revenue received as early as the 10th of the month, the 15th of the month and that to me was all I needed to know about when the money was received.

[fol. 9622] By Mr. Liftman:

Q. Mr. Dunn, looking at page 1 of Exhibit No. 221, I see that you deducted the cost of gas purchased during the year 1941 in the amount of \$1,480,917 from the total operation and maintenance for that year in the amount of \$3,392,827 to secure the balance of \$2,211,909. What did you then do with that amount to put it on a 45 day basis?

A. Divided by 365 for one day's basis, multiplied by 45 to extend that one day to 45 days.

Q. And that gave you what amount?

A. \$272,701.

Q. Which is the average cash required for operation and maintenance on a 45 day basis?

A. That is right.

Q. The next item is the sum of \$94,732 for "Prepaid Items at December 31, 1941". Where did you secure that figure?

A. That figure is a balance sheet item. The reference is to Exhibit No. 172, line 14, column M. The company pays certain expenses in advance of the period to which they [fol. 9623] relate. I have included the total of prepaid expenses in the working capital allowance.

Q. Now, the next item which you show is the sum of \$74,839 for "Materials and Supplies Inventory—12 31 41". Where did you secure that figure?

A. That is also a balance sheet item.

Q. As of December 31, 1941?

A. That is correct, appearing in Exhibit No. 172, line 13, column M. It is the actual inventory at December 31, 1941.

Q. Now, why did you select the day, December 31, 1941, as the basis for amount of materials and supplies?

A. The details of the materials and supplies account for the year 1941 are shown on page 3 of Exhibit No. 221. The inventory is considerable higher at that date than at any other period and higher than the average inventory

for the year 1941. The reason I selected the highest amount is because of Mr. Sperry's testimony that the company really felt it necessary to maintain a larger inventory than in the past.

Q. Now, looking at page 3 of Exhibit No. 221, I note that the balance at the end of January, 1941, for materials and supplies was \$211,075. Is that correct?

A. That is correct.

Q. And the balance at the end of each succeeding month was progressively—well, almost progressively greater, I think with but one exception.

[fol. 9624] A. It declined somewhat during the summer months. Other material was issued, I suppose for the repair and maintenance program during the summer time which brought the balance down a little bit in the summer months. That was increased along about September and increased each month up to December.

Q. At which time, that is, on December 31, 1941, the materials and supplies account stood at \$333,941?

A. That is correct. I might say that this is slightly different from the amount shown on page 1 due to the fact that there is about \$10,000 of materials and supplies in the gasoline plant which I did not bother with in this table.

Q. In other words, you included approximately \$10,000 more in your summary and ultimate estimate than the actual balance at December 31, 1941?

A. I did not mean it quite that way. They have really two inventory accounts, one for the gas business and one for the gasoline business and this analysis on page 3, is only for the gas business but, nevertheless, the gasoline business is a part of the company and I naturally included that material and supplies inventory. It was very small.

Q. The total of the items which you have mentioned is \$742,272 for Panhandle, Eastern and Illinois Natural. In your opinion, does this amount represent the maximum allowable working capital to be added to plant accounts [fol. 9625] and to be added to operating expenses for purposes of this proceeding?

A. It does represent the maximum amount. As I have indicated, the tax accruals are more than sufficient to provide all necessary cash working capital. In view of the fact that gas customers actually provide an ample amount of working capital through the medium of accrued taxes,

it is my opinion that no additional allowance for cash working capital need be separately provided for.

Q. However, you have included an allowance for cash working capital as shown on page 1 of Exhibit 221, have you not?

A. That is correct, I have.

Q. Have you made a study of the working capital requirements of Michigan Gas Transmission Corporation?

A. I have.

Q. I am going to ask you to refer to Mr. Spitznagle's exhibit on the subject of working capital which is Exhibit No. 94.

For purpose of the record, Mr. Spitznagle, a witness on behalf of Michigan Gas Transmission Corporation, testified on direct examination with respect to working capital at pages 1852-1856 of the transcript.

Do you have before you now Exhibit No. 94?

A. I do.

Q. Will you please go through the several items that are shown on the first page of that exhibit which summarize (fol. 9626) Mr. Spitznagle's allowance and state briefly which of these allowances you would recommend and which, in your opinion, represent necessary amounts of working capital for this company?

A. The first item, "Cash fund operating expenses" based on monthly average pro forma operating expenses, excluding purchased gas, taxes, prepayments, depreciation and amortization and using 45 days (average period in day's expense is paid before it is repaid by customer)" is shown in the amount of \$47,173.05. I have no reason to believe or see no objection to this amount. In fact, it is computed in almost the same manner that I recommended in the case of Panhandle Eastern. However, if we used the full year 1941, the amount would be slightly higher, I think about \$50,000.

Q. Instead of \$47,173?

A. Yes.

Q. In other words, his estimate speaks as of June 30, 1941, does it not?

A. That is correct.

Q. Mr. Dunn, it is a fact, is it not, that Mr. Spitznagle made no allowance for the cost of gas purchased, did he?

A. He did not. He said he had made an investigation of the item and could find no reason for including it in his working capital allowances.

Q. In other words, his estimate is very similar to yours [fol. 9627] in that regard?

A. It is.

Q. Very well. Now, will you go to the next item which is headed, "Materials and Supplies, Based on Actual Material and Supplies on Hand at June 30, 1941, Per Books, Plus Estimated Amount of Increase There Resulting from Change in Price to June 30, 1941," in the amount of \$100,923.78.

A. Referring to the materials and supplies account shown in Exhibit No. 163, page 1, the company actually had on hand \$115,053.90 representing the actual inventory of supplies and materials.

Mr. Wheat: What date is that?

The Witness: December 31, 1941.

Mr. Culton: Will you give the amount again, please?

The Witness: \$115,053.90. I would suggest this amount is being the proper allowance for working capital purposes.

By Mr. Littman:

Q. That is the amount as of December 31, 1941?

A. That is right.

Q. What do you say with respect to the third item, "Purchased Gas Cost for Line Pack after Deducting any Portion of Such Cost Capitalized, Based upon Average for 12 Months Ended June 30, 1941", in the amount of \$31,406.70 which Mr. Spitznagle included in his working capital allowances?

A. Well, Mr. Spitznagle was very careful in this adjustment [fol. 9628] but I think he made a very complicated computation to no purpose here.

Q. What did he do, briefly?

A. Briefly, he added \$31,406 to his proposed rate base but he deducted \$5,595 from his proposed operating expenses.

Q. From his annual operating expenses?

A. That is right. Such an adjustment results in a decrease in allowable revenue to the company and I believe

it is entirely unnecessary to make such an adjustment. The reason he had to make such an adjustment in operating expenses is because line pack, in the Michigan Gas system, was not the same each year and, having increased in the period June 30, 1941, over the prior year, he had to remove that increase from the operating expense, gas purchased, and, in effect, capitalize it by including it in working capital.

Q. How did the line pack increase? Was that by reason of additional pipe line or by reason of higher pressures?

A. Probably some of both. I am not certain but I did see that it had increased by that amount in his working papers.

I think a much more simple and probably even more accurate method of handling it is to allow the cost of gas purchased as an expense in the year it is purchased and omit this troublesome item of line pack from the working capital.

Q. What effect does that have? Is your recommendation (fol. 9629) in this regard much more liberal to the company than Mr. Spitznagle's treatment?

A. Yes. As far as this item is concerned, it would be just twice as good to the company.

Q. As far as Michigan Gas Transmission Corporation is concerned?

A. Yes.

Q. In other words, if I may summarize, what you propose to do is recommend the disallowance in working capital of the \$31,406 for gas purchase cost for line pack and to allow, in operating expenses, the \$5,000 odd incurred each year for the cost of gas in that connection, is that right?

A. That is correct.

Q. Now, will you please pass on to the next item of prepayments, which Mr. Spitznagle allows in the amount of \$4,538.55. What is your recommendation in that regard?

A. Since these items are actually prepaid, I think they should be allowed in working capital.

Q. What is the prepayment amount at December 31, 1941? You are, I presume, looking at the financial state-

ment of Michigan Gas Transmission Corporation for the necessary detail?

A. That is correct. The prepaid accounts are shown under the title "Deferred Debits."

Q. In what exhibit?

A. Of course, deferred debits are prepaid but the [fol. 9630] amount is shown on page 1 of Exhibit No. 163.

Q. That is the financial report for 1941 of Michigan Gas Transmission Corporation?

A. That is correct, in the amount of \$6,364,61.

Q. You would recommend the allowance of that amount as of December 31, 1941, rather than an amount at the midyear?

A. That is correct, for working capital purposes.

Q. Yes. What do you say with respect to the final item shown on page 1 of Exhibit No. 94 allowed by Mr. Spitznagle for "Minimum Bank Balances Required to Support Check Privileges Based Upon Advice Received from Depositories" in the amount of \$116,303?

A. The accrued taxes provide cash at all times far in excess of \$116,000 in much the same manner as it is with Panhandle Eastern and, therefore, I do not believe that this amount should be allowed in working capital inasmuch as the company has ample cash on hand from accrued taxes to cover any minimum bank balances.

Q. I believe the cross examination of Mr. Spitznagle covered that subject and showed the amounts, did it not?

A. Yes, Mr. Spitznagle, as I recall, admitted that the company had plenty of cash from accrued taxes to more than cover minimum bank balances.

Q. The record will show whatever his testimony was in that regard and will speak for itself.

[fol. 9631] Will you please total the items which, in your opinion, should be allowed for the working capital of Michigan Gas Transmission Corporation for purposes of this proceeding?

A. That total is \$171,419 obtained by using a round sum of \$50,000 for cash fund expenses covering operation and maintenance. I believe that actually works out slightly higher than this. I would recommend at least \$172,000.

Q. And does that amount represent, in your opinion, the maximum allowable working capital to be added to the

plant accounts and to operating expenses of Michigan Gas Transmission Corporation for purposes of this proceeding?

A. It does.

(Exhibit No. 221 was received in evidence.)

[fol. 9632] Mr. Littman: I would like to have marked for identification, Mr. Examiner, an exhibit consisting of two [fol. 9633] pages entitled, "Panhandle Eastern Pipe Line Company and Subsidiary Companies—Computation of Average Return Earned on Net Investment for the Period April 1, 1932 to December 31, 1941."

(The document referred to was marked Exhibit No. 222 for identification.)

Q. Mr. Dunn, what is the source of the information and data shown in Exhibit No. 222?

A. The sources are all indicated. Column (b) is taken from Exhibit No. 173, the income statement prepared by Mr. Watkins. That is a cumulative total from the beginning to December 31, 1941.

Q. The sources of the other figures, of course, you may explain as you go along and I think it will be apparent.

Trial Examiner: Before you leave that, what companies are included as subsidiaries in this study?

Mr. Littman: All of the companies shown in Mr. Watkins' Exhibit No. 112 which was furnished at my request, all of the subsidiary companies owned in each year by Panhandle Eastern. In other words, this exhibit is presented on the same basis as Mr. Watkins' accounting exhibits have been presented.

Trial Examiner: And, of course, does not include anything of Michigan Gas Transmission Corporation?

[fol. 9634] Mr. Littman: That is correct because the last period is December 31, 1941.

I might state in that connection that it is my understanding and I will have Mr. Dunn correct me if I am

wrong, that at no time did Panhandle Eastern Pipe Line Company own any considerable amount of distribution system property. In the early years, it owned more distribution system property than in the later years. As a matter of fact, on January 1, 1941, it owned no distribution systems and then as of some date in February, it recently acquired the Indiana Gas Distribution system which is a small company. However, this exhibit was made on a comparable basis so that it may be confirmed and compared with Mr. Watkins' own presentation.

By Mr. Littman:

Q. Is my statement generally correct, Mr. Dunn, about the distribution systems?

A. It is. They were at all times a very minor part of this company's operations.

Q. You had no way of eliminating them without going through a considerable amount of detailed work, did you?

A. That is right. In fact, for the purpose of this exhibit, I had no desire to eliminate them because I wanted to show what the total operations of Panhandle Eastern were as a corporation over this period of time.

Q. Very well. Will you please explain Exhibit No. 222?

[fol. 9635] A. Column (c) shows certain adjustments to operating expenses which I have entitled, "Adjustment for Items Admittedly Not Cost".

Q. Just a minute, have you sufficiently explained Column (b)? Let me repeat, Column (b) is the total operating revenue and operating revenue deductions and net operating revenue, per books, and as shown in Mr. Watkins' Exhibit No. 173 for the period April 1, 1932, to December 31, 1941, on a cumulative basis, that is, the total of all the figures in that period, is that right?

A. That is correct, it is.

Q. All right. Now, go to Column (c) and I might state for the purpose of the record that the net operating revenue shown, that is, the cumulative total, is \$31,929,484.

Now proceed to Column (c).

A. The adjustments to which I referred are explained on page 2 of this exhibit. The first one is an adjustment relating to amortization of limited term gas investments and pertains to the item of gas sales and purchase con-

tracts which were not stated at cost. The items which I have included in this exhibit, namely, the gas purchase and sales contracts in the amount of \$654,989.34 are contracts with Missouri Power & Light and Illinois Power & Light and certain industrial companies, which Panhandle Eastern secured by payment of some Mokon stock.

[fol. 9636] Q. Are you referring to the 19,000 shares of Mokon stock purchased by Panhandle Eastern and distributed by Mr. Parish, the then president of Panhandle Eastern?

A. That is the item to which I referred.

Q. And how much money is involved in the purchase of that stock, approximately?

A. The purchase of the stock was—

Q. (Interposing) The cost to Panhandle Eastern—

A. (Continuing) \$556,000. The total of this amount, to reconcile the figures here, shown as \$654,989.34 is represented by some additional payments, one of which is an amount of \$75,000 paid Missouri Kansas Pipe Line Company to reimburse them for expenses incurred in obtaining gas sales contracts and that amount was paid to the American Coke & Chemical Contracting Company plus an additional \$9,500 for securing the industrial contracts with Peoria Malleable Castings Company, Keystone Steel Company, Caterpillar Tractor Company and R. Herschel Manufacturing Company. Then there were some expenses in the amount of \$786.30, a premium on a bond amounting to \$1,000 and then, later on, in 1931, and 1932, an amount of payroll and expenses of \$12,763.04, all of these relating to the gas sales contracts that I have described.

Q. Well, at any rate, the bulk of the item of \$654,000 odd was made up of the \$500,000 odd which was paid by [fol. 9637] Panhandle Eastern for the acquisition of 49,000 shares of Mokon stock which was given to Mr. Parish as president of the company to distribute for the acquisition of the Missouri Power & Light Company and the Illinois Power & Light contracts, is that a correct summary?

A. That is correct. The exact amount is \$556,000.

Q. Did you hear Mr. Maguire testify he rendered all of the services in connection with the securing of those contracts and that he received but 7,000 shares of that stock?

A. Yes, I heard Mr. Maguire's testimony to that effect.

Q. But you are not making any disallowance of any of this \$654,000 item, are you? That is, you are not recommending any disallowance for the purpose of this proceeding?

A. No. The fact I do not see how it can be disallowed. It has all been written off. In effect, more than that has been written off and the company has already disposed of the item.

Mr. Culton: In other words, it is not in their accounts at this time?

The Witness: I do not see how it could be considered in their accounts at this time.

By Mr. Littman:

Q. It has been amortized?

A. That is right.

Q. Very well. This, of course, is the amount before [col. 9638] amortization, is it not, \$654,989?

A. That is right.

Q. Will you proceed with your explanation?

A. Then an amount has been amortized for other gas sales and purchase contracts in the amount of \$174,689.20 which is the total allowable amortization for this item in the sum of \$829,678.54.

Q. Which is the amount which you are permitting to remain intact?

A. Yes. We can see, from Column (c) that the company has really amortized \$1,231,870 more than cost in the past.

Q. All right. Will you proceed with your explanation of this exhibit?

A. The next adjustment I made is self-explanatory. It is charges in lieu of Federal income and excess profits taxes and that is not cost because it represents the amount of taxes which would have been paid had the company not engaged in the refinancing operations in 1941 and since it was not paid, I have not included it in this study of actual expenses.

Q. In other words, they were charges that were accrued but not paid, is that right?

A. That is right.

Q. And, of course, to that extent, the net operating revenue of the company was understated?

A. Yes.

[fol. 9639] Q. And accordingly adjusted by you. Will you proceed with the next item of adjustment?

A. The other adjustments relate to taxes and are taken from certain exhibits presented by Mr. Watkins to show the difference between taxes actually paid and the taxes accrued. There is a reference in each instance to the exhibit and it shows that, in the case of miscellaneous Federal taxes, State and local taxes, about \$69,550 was over accrued. In the case of Federal income taxes, about \$600,530 and Federal excess profits taxes, \$219,881. The sum of all these adjustments which have been included as operating expenses amount to \$2,945,713.

Q. In your opinion, has the net operating revenue of Panhandle Eastern Pipe Line Company and subsidiary companies, on a consolidated basis during the period from April 1, 1932, to December 31, 1941, been overstated, cumulatively speaking, in the amount of \$2,945,713?

A. The operating expenses have been overstated by that much or the operating revenue has been understated by that much.

Q. Now, that gives us what net operating revenue, as adjusted, as shown in Column (d)?

A. \$34,875,197.

Q. And what do the figures in Column (e) represent on page 1 of Exhibit No. 222?

A. That is the annual average obtained by dividing the [fol. 9640] totals in Column (d) by the period of time which is 93 1/2 years.

Q. What is the average net operating revenue for that period?

A. \$3,576,943.

Q. I note a figure in line No. 27 denominated "Average Net Investment" in the amount of \$47,774,469. Do you have a tabulation in this exhibit which shows how you arrive at that amount?

A. Yes, that is shown at the top of page 2.

Q. Will you explain that tabulation?

A. The gas plant totals shown in Exhibit No. 176, line 38, are listed by years, showing the balance at December 31 for each year. I have added to that the net amount of gas sales contracts shown on line 44 of Exhibit No. 176. I have deducted the balance in the reserves for depreciation

and depletion corresponding to the proper years as shown in Exhibit No. 172, lines 28 to 33, inclusive, and the last column shows the net investment. I have totaled that and divided by 10 to get an average because there are 10 years involved.

Q. That gave you the amount of \$47,774,469, does it not?

A. It does.

Q. At line 28 at the foot of page 1 of Exhibit No. 222, you have shown 7½ percent as the "Average Returned [fol. 9641] Earned". Shouldn't that be corrected to "Average Return Earned"? That "ed" on "Return" does not belong there.

A. That is a typographical error. That should be "Return."

Q. Now, will you explain that item?

A. The company's income statements, particularly the Exhibit No. 173, show that they have earned a fluctuating amount of net income, some years rather high and some years very low. I wanted to see what the average would be to know what the results of operation were more intelligently and that showed they earned on the average 7½ per cent.

Q. On their net investment as shown in Exhibit No. 222?

A. That is correct.

Q. And that is the amount that is sometimes called "net operating revenue"?

A. That is correct.

Q. Expressed in percentage of net investment?

A. Yes.

[fol. 9642] (Exhibit No. 222 was received in evidence.)

[fol. 9650] Mr. Culton: Mr. Examiner, I have distributed a number of proposed exhibits and I would like to have them marked for identification at this time. I think that will be a time saving matter.

I ask first that the document entitled, "Substitute Estimate (Less Economic) of Additional Capital Expenditures

South and West of Liberal Compressor Station Required to Meet Peak Day Sales of 307,000 MCF" be marked Exhibit No. 223 for identification.

(The document referred to was marked Exhibit No. 223 for identification.)

Mr. Culton: I ask that the document entitled, "Substitute Estimate (Less Economic) of Additional Capital Expenditures South and West of Liberal Compressor Station, Required to Meet Peak Day Sales of 338,000 MCF" be marked Exhibit No. 224 for identification.

(The document referred to was marked Exhibit No. 224 for identification.)

Mr. Culton: May we reserve Exhibit No. 225 for an exhibit which has not yet been completed but which, in regular order, I think should go in at this point?

[fol. 9651] Trial Examiner: We will reserve that number.

Mr. Culton: It will be for a document entitled, "Estimate of Operation and Maintenance Costs South and West of Liberal Compressor Station, Panhandle Field, 307,000 MCF Continuous Daily Sales Capacity Operation at 50 Per Cent Capacity Factor."

(Exhibit No. 225 was reserved for exhibit to be submitted later.)

Mr. Culton: We ask that the document entitled, "Estimate of Operation and Maintenance Costs South and West of Liberal Compressor Station, Panhandle Field, 307,000 MCF Continuous Daily Sales Capacity Operation at 90 Per Cent Capacity Factor" be marked Exhibit No. 226.

(The document referred to was marked Exhibit No. 226 for identification.)

Mr. Culton: The next exhibit is entitled, "Estimate of Operation and Maintenance Costs South and West of Liberal Compressor Station, Panhandle Field, 338,000

MCF Continuous Daily Sales Capacity Operation at 70 Per cent (Approximately Normal Capacity Factor" be marked Exhibit No. 227.

(The document referred to was marked Exhibit No. 227 for identification.)

Mr. Culton: We ask that the document entitled, "Estimate of Operation and Maintenance Costs South and West [Vol. 9652] of Liberal Compressor Station, Panhandle Field, 375,000 MCF Continuous Daily Sales Capacity Operation at 90 Per Cent Capacity Factor" be marked Exhibit No. 228.

(The document referred to was marked Exhibit No. 228 for identification.)

Mr. Culton: We ask that the document entitled, "Capacity Study April 7, 1942 Continuous Daily Delivery Capacity 307,000 MCF" be marked Exhibit No. 229.

(The document referred to was marked Exhibit No. 229 for identification.)

Mr. Culton: We ask that the document entitled, "Capacity Study April 7, 1942 Completely Looped and Economically Powered Main Line System with Economic Production Transmission Expenditures" be marked Exhibit No. 230.

(The document referred to was marked Exhibit No. 230 for identification.)

Mr. Culton: I ask that the document entitled, "Capacity Study April 7, 1942, Revised Completely Looped and Economically Powered Main Line System with Less Economic Production Transmission Expenditures" be marked Exhibit No. 231.

(The document referred to was marked Exhibit No. 231 for identification.)

[fol. 9653] EDWARD L. DUNN, a witness, having been previously duly sworn, resumed the stand and testified further as follows:

Redirect Examination

By Mr. Littman:

Q. Mr. Dunn, when you were on the stand near the close of the last session, were you requested to furnish certain data and information?

A. I was, yes.

[fol. 9654] Q. And have you prepared that information and data in response to those requests?

A. I have.

Q. I call your attention particularly to a request that was made by Mr. Chamberlain with respect to Exhibit No. 222 entitled, "Panhandle Eastern Pipe Line Company and Subsidiary Companies—Computation of Average Return Earned on Net Investment for the Period April 1, 1932, to December 31, 1941". Have you prepared a table in response to Mr. Chamberlain's request with respect to Exhibit No. 222?

A. I have.

Mr. Littman: I ask, Mr. Examiner, that a table consisting of one page, entitled, "Panhandle Eastern Pipe Line Company and Subsidiary Companies—Comparison of Average Return Earned on Net Investment for the Periods April 1, 1932, to December 31, 1936, and January 1, 1937, to December 31, 1941", be marked for identification as Exhibit No. 232.

Trial Examiner: Would it not be better, Mr. Littman, to mark this exhibit No. 222-A?

(The document referred to was marked Exhibit No. 222-A for identification.)

By Mr. Kittman:

Q. I hand you Exhibit No. 222-A for identification, Mr. [fol. 9655] Dunn, and ask whether this is the table you prepared in response to Mr. Chamberlain's request?

A. It is.

Q. Will you briefly explain this exhibit, giving only such detail as is necessary to explain the exhibit briefly?

A. This exhibit is supplementary to Exhibit No. 222 which showed the average return earned over the entire corporate history of Panhandle Eastern Pipe Line Company and its subsidiary companies. The purpose of this exhibit is to break that down into two divisions, namely, the period from 1932 to 1936, inclusive, and—

Q. (Interposing) You mean from April 1, 1932, to December 31, 1936?

A. Yes, and the period beginning in 1937 and ending in 1941.

Q. That is, from January 1, 1937, to December 31, 1941?

A. That is right. Therefore, I started with the total which is shown in Column B of Exhibit No. 222 and divided that into the periods mentioned. The operations are accounted for by years and, of course, I used the years as they are accounted for on the company's books for the purposes of this division.

There is one exception to that statement. In the case of the amortization of gas contracts, that amount is shown as \$829,679 for the total. The amount applicable to the first period is one-half of the amount of \$654,990 shown in [fol. 9656] the amount of \$327,495 under "Amortization of Gas Contracts" in the column under the period 1932 to 1936. The other half is included in the period 1937 to 1941 plus the amortization of the gas contracts new which were entered into during the latter half of this period, namely, the period 1937 to 1941. Therefore, all of the amortization has been applied to that period.

Q. Mr. Dunn, your Exhibit No. 222 showed that Panhandle Eastern Pipe Line Company and its subsidiary companies earned an average return of 7½ per cent per year over the period April 1, 1932, at which date it actually

commenced its operations through December 31, 1941. Is that correct?

A. That is correct.

Q. Now, what you have done in Exhibit No. 222-A is to divide that period into two separate periods so as to show the average return earned during the period from April 1, 1932, through December 31, 1936, on the one hand, and for the period January 1, 1937, through December 31, 1941, on the other hand. Is that right?

A. That is right.

Q. Over the first period, the average return earned by Panhandle Eastern Pipe Line Company and subsidiary companies was what per cent of its net investment?

A. 21 per cent.

Q. And what was the average return earned, as shown [fol. 9657] on Exhibit No. 222-A, on the latter period, to-wit, from January 1, 1937, through December 31, 1941, on the net investment?

A. 10.64 per cent.

Q. Now, you made this separation at the request of Mr. Chamberlain, did you not?

A. That is correct.

Q. State whether or not it is the fact that the Detroit business was attached along toward the latter part of 1936?

A. Yes, it was.

Q. So that your latter period reflects the operations and return to Panhandle Eastern after the Detroit, Michigan, load was fully attached, does it not?

A. It reflects the actual sales to the Michigan Consolidated Gas Company, in full.

Q. And, of course, the first period from April 1, 1932, through December 31, 1936, reflects the operations before the Detroit load was attached to the lines, is that correct?

A. Yes. There are some Detroit sales in there undoubtedly for a portion of the year 1936 but not a substantial amount, according to the company's statements of operating revenues.

Q. Now, did you also prepare a table in response to the Trial Examiner's request which was to this effect: That you prepare a table showing the average earned on the net investment of the Michigan Gas Transmission

[fol. 9658] Corporation for the period March 1, 1936, to December 31, 1941?

A. I did.

Mr. Littman: I ask that this table be marked for identification as Exhibit No. 222-B inasmuch as it is a similar computation to those which preceded it.

(The document referred to was marked for identification as Exhibit No. 232.)

By Mr. Littman:

Q. I hand you a copy of Exhibit No. 232 for identification, Mr. Durin, entitled, "Michigan Gas Transmission Corporation—Computation of Average Return Earned on Net Investment for the Period March 1, 1936, to December 31, 1941", and ask you whether this is the table which you prepared in response to the Trial Examiner's request to which I referred a moment ago?

A. It is.

Q. Will you briefly explain this table?

A. This table is taken from the income account, per books, shown as Exhibit No. 99 up to the end of December 31, 1940, and Exhibit No. 163 for the year ended December [fol. 9659] 31, 1941. Cumulative totals are shown in the first amount column. The second column includes an adjustment for taxes not paid, the amounts being taken from Exhibit No. 99. The third column shows the cumulative totals, as adjusted, and the fourth column shows the average amounts over the life of Michigan Gas Transmission Corporation ending December 31, 1941, which is a period of 5 5/6 years.

Q. What is the source of the figures shown in Exhibit No. 232?

A. The source is Exhibit No. 99 and Exhibit No. 163.

Q. Which, in turn, reflect the company's books, do they not?

A. That is correct.

Q. And the same is true of Exhibit No. 222-A; that is, to say, the figures reflect the company's books, do they not?

A. That is right, except for certain adjustments which were explained in connection with Exhibit No. 222.

Q. What does your Exhibit No. 232 show to be the average return earned by Michigan Gas Transmission Corporation on its net investment from March 1, 1936, through December 31, 1941?

A. This exhibit shows that that corporation earned an average of $8\frac{1}{2}$ per cent on an average net investment of [fol. 9660] \$9,134,568 for that period.

Q. By "net investment" are you referring to book costs of the gas plant less depreciation reserves?

A. That is correct, less an adjustment for an item of intercompany profit which is shown on the bottom of this exhibit.

Q. You mean the figures shown in the column headed, "Net Adjustment for Intercompany Profit"?

A. That is correct. That amount was approximately \$139,500. It is depreciating about \$3,600 a year or, at the end of 1941, it had depreciated to approximately \$103,500. At the end of the preceding year, at the end of 1940, it was \$107,100 or \$3,600 less, which is carried on back to 1936 in that manner.

Q. As that the intercompany profit to which numerous references have heretofore been made in this proceeding, namely, the profit that was taken by Columbia Engineering Corporation from Michigan Gas Transmission Corporation's predecessor, Indiana Gas Transmission Corporation?

A. Yes, it was a construction fee, not actual cost, which was paid to an affiliated company by a predecessor company.

Q. That is the intercompany profit referred to by the Securities and Exchange Commission in its opinion which is in evidence as Exhibit No. 147, is it not?

A. That is correct. The real source of the item is disclosed in Mr. Spitznagle's original cost study, however.

[fol. 9661] Q. Which is Exhibit No. 91, as I recall it?

A. I believe it is.

Q. Mr. Dunn, you have just alluded to two adjustments which were made in Exhibit No. 232 shown in the second column for taxes not paid. Is my understanding correct

that, in certain years, Michigan Gas Transmission Corporation accrued on its books an amount greater than the amount of taxes actually paid?

A. That is correct.

Q. And, to that extent, understated its net income per books?

A. That is a result of the over-accrual, yes.

Q. And you have shown the amount of these understatements, to wit, the amount of the accrual for taxes not paid and accordingly you have made the adjustment in Exhibit No. 232?

A. Yes.

[fol. 9663] Q. You have used the terminology, "average net investment"?

A. Yes.

[fol. 9664] Q. In fact, you have taken the gas plant at the close of each year, have you not?

A. I have.

Q. And you have applied to that the revenues for the year?

A. That is not.

Q. So that it is not the return upon the average investment for each year?

A. Well, that is not what the exhibit shows. It shows the average for six years and I divided by six to get an average for six years, not an average for individual years.

Q. I see. In the ultimate figure, you take the average for the full period?

A. That is correct.

[fol. 9668] (Exhibits Nos. 222-A and 232 were received in evidence.)

[fol. 9669] C. H. HINTON, a witness, having been previously duly sworn, resumed the stand and testified further as follows:

Mr. Culton: "Mr. Examiner, in line with the suggestion of the Examiner a few days ago, I will make a statement

with respect to the former testimony to which the next witness' testimony is related.

This witness heretofore testified and presented his written testimony which appears as Exhibit No. 42. In connection with that, he offered certain schedules in Exhibit No. 43. His examination appears at three places in the transcript. He was first offered at page 654. Later, there was direct examination at page 1306 and the cross-examination commenced at page 4775.

This witness' former testimony, among other things, related to the capital expenditures which will be required in the two fields in which Panhandle Eastern's reserves are located in order to meet certain volumes and peaks as estimated by Mr. Morton. He also in his exhibit presented the operation and maintenance costs in the field and, by the field, I mean west of Liberal.

His testimony will relate to a further study which he has recently made based on changed conditions. His estimated future expenditures, as contained in his former [fol. 9670] testimony under what was referred to as the anticipated load, commenced on page 26 of Exhibit 42 and for the expenditures through 1946 carried through page 32.

By Mr. Culton:

Q. Mr. Hinton, in your former testimony on page 26 of Exhibit 42, you detailed certain future capital expenditures in what was referred to as the anticipated load. I will now ask you to state what has been done with respect to the various items referred to under 1941 as it appears on page 26 of that exhibit?

A. All of the items which were proposed for 1941 have now been completed with the exception of the acidization of the gas well shown under item D. That is a matter of about \$1,550. That work has not yet been done.

Q. That is largely due to circumstances related to other matters, is it not?

A. It is a matter of holding off on that acidization until such time as we have gas available to load the acid for gas treating rather than using liquid as a drive.

Q. In other words, it will be more economical and more efficient to be able to acidize it in the way you have described?

A. We find we have better results by using a partial [fol. 9671] water load and partial gas load and we are going to hold up that acid treating until such time as we have the gas load available.

Q. This well is that which was drilled in what was, in effect, a new field so far as Panhandle Eastern is concerned, that is, a new area?

A. That is correct. That is our first well.

Q. And I believe it was practically completed the last time you testified?

A. Yes, sir.

Q. What kind of a well did you get from that area?

A. Well, we have a natural open flow there of approximately 5 million cubic feet per 24 hours tested on a 20 minute blowdown pitot test and we feel that is an indication that we have some pretty good acreage surrounding that well.

Mr. Littman: May I inquire whether that 5 million open flow was before or after acidization?

The Witness: Before. The well has not been acidized.

Mr. Littman: You fully expect the well to be greater after acidization, do you not?

The Witness: Yes, we hope so on a pitot tube test of 5 million, I would estimate that we would go to somewhere around 25 to 30 million.

By Mr. Culton:

Q. In other words, you feel, as a result of the drilling [fol. 9672] of that well, that you have proven that the Panhandle acreage in that area is substantial acreage which it will pay the company to develop?

A. Yes, and other wells drilled in the vicinity further prove it, that is, wells owned by other companies.

Mr. Littman: Will you please give us the location of that well?

The Witness: The well is located in the north half of Section 25, Township 3, Range 15 and it shows on that map to be located in the center of the west half but we changed that location after this map was made.

Mr. Littman: In what State and in what county?

The Witness: Texas County, Oklahoma.

Mr. Littman: What was the thickness of the lime?

[fol. 9673] By Mr. Culton:

Q. Since you formerly testified, have you had occasion to make any computations with respect to future capital expenditures on any basis other than that on which your anticipated load capital expenditures, as reflected in Exhibit No. 42, was prepared?

A. Yes, I have.

Q. What was the basis on which the anticipated load capital requirements, contained in Exhibit 42, was based?

A. They were based upon estimates of Mr. O. W. Morton.

Q. Reflected in his Exhibit No. 40?

The Witness: The figures which appear on Exhibit 40 are the same as those that were furnished me by Mr. Morton on August 18.

[fol. 9674] Q. In your former study, you took into consideration the volumes of gas shown on Exhibit 40 as well as the maximum day requirements; is that correct?

A. That is correct.

Q. You state that recently you have made another study of capital requirements. What has been the basis of that study?

A. That study is based upon volumes of gas which have been given me by the management of the company.

Q. By the management. You mean the president, Mr. Creveling?

A. Yes, sir.

Q. And what bases were used, what capacity?

A. The volumes which he gave me were continuous daily capacity of 307,000 M.c.f. operating at a capacity factor of both 70 per cent and 90 per cent and a volume of 338,000 M.c.f. peak day sales and that was to be designed for continuous operation and the estimates were based upon a 70 per cent capacity and a 90 per cent capacity factor on that volume also.

Q. In other words, you have made computations for capital expenditures first to meet sales of 307 million daily and second, to meet sales of 338 million daily, is that correct, peak sales?

A. Yes, and I was also instructed to use the minimum amount of steel in both cases.

[fol. 9675] Mr. Littman: When you speak of 338 million and 307 million, you are speaking of cubic feet, are you not?

The Witness: In M.c.f.—

Mr. Littman: (Interposing) No, you mean 338,000 M.c.f. or 338 million cubic feet.

The Witness: You are correct, Mr. Littman.

By Mr. Culton:

Q. The first exhibit which you offer and which has been identified for use in connection with your testimony relates to substitute estimate, less economic, of capital expenditures. What did you consider the most economic method of doing the necessary construction work?

A. The same construction program as outlined in Exhibit 42, pages 26 to 32.

Q. Approximately what annual volume did you take into consideration in the preparation of Exhibit No. 223?

A. The annual volume required at the intake side of Liberal compressor station to furnish the 307,000 M.c.f. at a 70 per cent capacity factor is 76,953,656 M.c.f. and that is on a 16.4 pound pressure base.

[fol. 9676] Q. In other words, it is approximately 77 billion cubic feet?

A. That is correct.

Mr. Littman: Will you explain or define the term "capacity factor" as you use it?

The Witness: That means that the pipe line would be operating at 70 percent of its capacity of 307,000 M.c.f. per day.

By Mr. Culton:

Q. At about what period in Mr. Morton's Exhibit No. 40 would you have reached that volume of annual sales?

A. We would have reached approximately that volume for the year 1944.

Mr. Littman: You mean 1943, don't you, Mr. Hinton?

The Witness: No, sir.

Mr. Culton: It is between 1943 and 1944, isn't it?

The Witness: Yes, it is between 1943 and 1944.

Mr. Littman: The reason I wondered whether he had misspoken himself was because of Column E of Exhibit 40, Mr. Morton's exhibit, which showed the annual requirement for the year 1943 to be 77,461,000 M.c.f.

The Witness: Yes, but the amounts on Exhibit 40 will not tie into this because this has the fuel added in required beyond Liberal station and including Liberal station and is converted from a 30-inch saturated pressure base which is 14.73 pounds to 16.4 pounds for the purpose of production because all production, in both the Panhandle and Hugoton fields is measured on a 16.4 pound pressure base.

By Mr. Culton:

Q. In other words, Mr. Morton's figures were sales figures whereas you have included everything?

A. Yes, sir.

Q. Sales, line loss and fuel.

A. And gasoline plant shrinkage.

Q. Gasoline plant shrinkage and so forth?

A. Yes, sir.

Q. And you have also changed the measurement basis to the field standard of 16.4?

A. Yes, sir.

Q. Exhibit No. 224 for identification shows the less economic substitute estimate required to meet peak day sales of 338 million cubic feet. What would the total volume be on that basis, approximately?

A. When you speak of the total volume, you mean—

Q. (Interposing). Annually.

A. Annually, at a 70 per cent [capacity] factor?

Q. At 70 per cent and 90 per cent.

A. The one we gave there on the 307,000 M.c.f. was at 70 and we have not yet given the 90.

[fol. 9678] Q. Give the 90—you have given us the 70 on the 307,000 M.c.f., is that right?

A. Yes, sir.

Q. Give us the 90 per cent capacity factor on the 307,000 M.c.f.

A. The annual requirement at 90 per cent capacity factor would be 98,940,368 M.c.f., approximately.

Q. Was that figure reached on Mr. Morton's Exhibit No. 40?

A. I do not know how many years he went on that exhibit.

Q. He used through 1946.

A. No, Mr. Morton gave me estimates beyond those shown in Exhibit 40 and a comparable load condition would not be reached under his estimate until the year 1947. That is, it would occur between 1947 and 1948.

Q. Now, will you tell us the annual volume required to meet sales of 338 million at a 70 per cent capacity factor?

A. The annual requirement for 338,000 M.c.f. capacity operating at 70 per cent capacity factor would require annually 85,954,285 M.c.f.

Q. And when would that point be reached on Mr. Morton's Exhibit No. 40?

A. That would be reached approximately the year 1946. It would occur between the year 1945 and 1946, the estimate for that year.

[fol. 9679] Q. What would be the annual requirement to meet sales of 338 million operating at a 90 per cent capacity factor?

A. The requirement under that condition would be 110,512,512 M.c.f.

Q. And that point would be reached sometime beyond the date covered by Mr. Morton's five year estimate, would it not?

A. Yes.

[fol. 9681] Mr. Littman: Do these annual figures that you have read into the record reflect the line loss, company use, and so forth?

The Witness: Yes, they do.

Mr. Littman: That is, they include the line loss?

The Witness: That is correct.

Mr. Littman: Have you estimated how much of these annual amounts is actually going to be sold?

The Witness: Yes, that is the volume that they gave me and I worked backwards from that. You see when Mr. Creveling told me to figure out the least steel possible to supply these volumes, then it was necessary for me to start at the sales end of the line and work backwards to the well.

Mr. Littman: The only figure he gave you was the 338,000 M.c.f. and the 307,000 M.c.f.?

The Witness: That is correct.

Mr. Littman: That was your starting figure and you worked back to these annual figures?

The Witness: Yes, sir.

Mr. Chamberlain: And that was sales?

The Witness: Yes, that is sales.

[fol. 9686] Mr. Littman: Mr. Hinton, is my understanding correct that the annual figures which you have read into the record with respect to Exhibits Nos. 223 and 224, that is, the annual figures, are comparable to the annual figures shown on page 15 of your Exhibit No. 42?

The Witness: Yes, I had forgotten they were there but they are.

Mr. Littman: In other words, the annual delivery figures which you have read into the record are the amounts which are required, either delivered at Liberal compressor station or adjusted to a 16.4 pound base with an addition for the gas required for the power and loss due to line leakage?

The Witness: That is correct.

Mr. Littman: And are comparable to annual figures shown by you on page 15 of Exhibit 42?

The Witness: Yes, sir.

The Witness: They include the same thing and are on the same pressure base.

By Mr. Culton:

Q. And your computation is on the assumption that the company would get those volumes at an earlier date than estimated by Mr. Morton?

A. Yes, and the time element enters in our expenditure [fol. 9687] requirement.

Q. And it has been on the assumption that the company would have those volumes just as soon as it could by physically possible for the additional expenditures to be made?

A. That is the way I understood that it was. In all probability, the fuel would be used for plants now engaged in making war materials and that it was a hurry-up job and to get the most possible there with the least steel.

Mr. Littman: You are now reflecting your understanding of what Mr. Creveling wanted you to do?

The Witness: Yes.

Mr. Littman: He gave you the hypothesis and you worked out the result?

[fol. 9688] By Mr. Culton:

Q. Mr. Hinton, you stated that the management gave you instructions to prepare further estimates as to capital expenditures, one to meet sales of 307,000,000 cu. ft. and the

other to meet sales of 380,000,000 cu. ft., using both the 70 per cent capacity factor and the 90 percent capacity factor, is that correct?

A. That is correct.

Q. And you said something about the difference in steel requirements. Just what instructions were those?

A. Well, they were not hardly instructions. That is, Mr. Creveling said, "Just what is the least number of tons of steel that you can get this gas into Liberal with?" and for me to make my computations upon that basis, and that is what I have done.

Q. That is, irrespective of whether or not it was the most economic way to furnish the capacity, is that correct?

A. That is correct.

Q. That resulted in what principal differences between your estimates this last time and the estimates which you made last fall, what fundamental differences?

A. Well, fundamentally it is just a shift of the problem from furnishing pipe line capacity, and converting to horsepower.

[fol. 9689] Q. In other words it results in less pipe and more compressor stations?

A. That is correct.

Q. Or compressor units?

A. That is correct.

Q. Now, does it make any difference in where the principal portion of the additional gas will be taken?

A. Yes, it makes a decided difference, because without steel we are not able to reach the pipe line capacity from Texas that we had anticipated under the study shown on Page 27 of Exhibit 42.

Q. Does it also necessitate, in later years, the construction of the gathering lines in Oklahoma about which you testified to?

A. If I—maybe you had better state that question again.

Q. All right. In this new study have you assumed that you would never construct the gathering lines in Oklahoma?

A. No, sir.

Q. Which you have heretofore testified you would construct around Oklahoma?

A. There will be no gathering lines constructed in the state of Oklahoma other than one small line which has not been considered in this study at all.

[fol. 9690] Q. Will these additional capital expenditures about which you will testify, such as reflected in Exhibits 223 and 224, fit into the eventual economic picture which you had presented in connection with your former testimony?

A. Part do and part of them do not.

Q. Will you be able, at the proper time to explain which ones you hadn't taken into consideration in your general study heretofore?

A. Yes, sir.

Q. I note that Exhibit 42, on Pages 27 and 28, list capital expenditures for the year 1942, aggregating \$4,530,470, whereas your Exhibit 223 for a peak day sales of 307 million cubic feet shows an expenditure in 1942 of \$1,335,304, and for 338 million cubic feet an expenditure of \$1,878,096.

Do you have a copy of your Exhibit 42 before you?

A. I do.

Q. Your first item—that is, item A for 1942—shows the drilling of five wells in the Panhandle field, whereas the exhibit 223 and exhibit 224 show only three wells.

What is the reason for the reduction in those two wells?

A. The chief reason is to cut down on the tons of steel required.

Q. In other words, if you had these additional wells, [fol. 9691] then you would have to have more steel for gathering lines, is that correct?

A. And we would have to use more of our casing to case the well.

Q. That is a steel saving proposition then?

A. That is right.

Q. Now, in your exhibit 42 you show installing liners in two old wells, and tubing in two old wells, and the same is shown in Exhibits 223 and 224. Are those the same wells?

A. Yes, those are the same wells, but under item C of Exhibit 242 the cost was estimated at \$4,262 for the tubing.

We have since revamped that and, by cause of further study, have decided to use a larger production string in those wells and that has been increased to \$6,900.

Q. In other words you think you would get better results by using larger string in those wells than you had originally planned, is that correct?

A. Yes, sir; that is correct.

Q. Now, in your former exhibit you showed acidizing five wells in the Panhandle field, whereas you now show acidizing ten.

Will the acidization of those additional wells give you greater volumes?

A. Yes. The wells will be able to deliver greater volume [fol. 9692] times of gas at a comparative working pressure.

Q. Now, in your former exhibit you showed well lines for five wells, and measuring stations for five wells, whereas that has now been reduced to three. That is because you have reduced the number of wells which will be drilled in the Panhandle?

A. That is correct.

Q. Then Item G shown in 1942 on Exhibit 42 and Item H shown on Exhibit 42 are not reflected in either Exhibit 223 or 224. What is the reason for that?

A. That is a matter of cutting down on the steel requirement.

Q. Does cutting down the steel requirements for the trunk gathering line and the increase in the capacity of the gathering line make any difference in the volumes of gas which you will be able to take out of the Panhandle field?

A. Yes. They make a decided difference.

Q. And you show Items G and H in Exhibit 223 representing the installing of additional horsepower at Sneed and Hansford.

Those are the same items, are they not, as those similar items in Exhibit 42?

A. Yes, that is correct, and even though we will be able to take less gas from the Panhandle field, the horsepower

requirement will be approximately the same, due to the [fol. 9693] fact that we will have to have a lower intake pressure at the Sneed compressor station, because we will have a limited line capacity.

Q. In Exhibit 223 and Exhibit 224 you show acidization of 20 wells in the Hugoton field, whereas I believe in your old Exhibit 42 you showed acidization of only ten wells.

What is the reason for that change?

A. That is because we are going to have to take more gas from each well which is now drilled than we would if we would have gone ahead and drilled the 20 contemplated wells in Oklahoma.

Q. It is the result, then, is suspending the drilling of additional wells in the lower part of the Hugoton field and taking increased volumes of gas from the other portions of that field, is that correct?

A. Well, it is a matter of taking more gas from Hugoton field over the entire field. That is, if I understood you correctly, you said that it meant taking less gas from one portion of Hugoton field, and a greater portion from another, but the takes will still be governed by proration, as nearly as it will be possible to do so.

Q. That is, so far as you have gathering facilities to gather the gas?

Mr. Littman: Pardon me, Mr. Culton. Where do you show in Exhibit 42 that you had proposed to acidize in [fol. 9694] 1942 more than four old wells in the Hugoton field?

The Witness: That is a typographical error, and I believe that was corrected in the record, because the unit cost of the acid treatment is \$1,550.

Mr. Littman: Unit cost?

By Mr. Culton:

Q. In other words the item \$15,500 under Item O is the cost of acidizing ten wells and not the cost of acidizing four wells; is that correct?

A. That is correct, and I thought that that was brought up one time during cross examination.

Mr. Culton: I have my exhibit marked there changed from four to ten.

Mr. Littman: I have no recollection of that change having been made, but if there is a correction to be made on Page 27 of Exhibit 42 let's do it now.

Should that read "Acidize ten old wells in Hugoton field, cost of \$15,500"?

The Witness: Yes, sir.

By Mr. Culton:

Q. In other words your unit cost—the aggregate cost represents the unit cost of ten wells?

A. Yes, and my working papers show what ten wells were to be acidized.

[fol. 9695] Mr. Littman: Are these 20 wells proposed to be acidized as shown on Exhibits 223 and 224 all old wells?

The Witness: Yes. By "old wells" you mean wells that have been drilled previous to this date?

Mr. Littman: I mean old wells in the same way that you used the term "old wells" in Exhibit 42. I take it you have defined it.

The Witness: Well, my definition for an old well is one that has been completed and has been producing gas into the pipe line for some time.

Mr. Littman: That is what you meant when you used that term in Exhibit 42?

The Witness: Yes, sir.

By Mr. Culton:

Q. Now, in your Exhibits 223 and 224 you show compressor station near Hugoton, Kansas, and a dehydration plant?

Mr. Littman: How about the office building in the [fol. 9696] Hugoton? You skipped that.

Mr. Culton: That is the same, is it not, in all the exhibits?

The Witness: Yes.

Mr. Culton: That was also in the original 42. I am just going to the change now.

Q. Was this compressor station near Hugoton and dehydration plant used in the old Exhibit 42?

A. No. Not for the year '42, but it does appear for the year 1946 under the anticipated load.

Mr. Littman: Where is that shown? What page and what item?

Trial Examiner: Did Mr. Culton's question contemplate the year 1942—

Mr. Culton (Interposing): Yes, sir.

Trial Examiner (continuing):—or Exhibit 42?

Mr. Culton: It happens to be both in that particular instance, Mr. Examiner, but I meant the Exhibit 42 under the year 1942.

The Witness: That is shown on Page 31 under item I and J.

Mr. Littman: On what page?

The Witness: 31. Item I and J.

However, the horsepower requirement for the stations [fol. 9697] shown in Exhibit 42 Page 31, Item I, is not the same horsepower as that proposed shown in Exhibit 223 and 224.

Mr. Culton: What is the difference?

Mr. Littman: What are the horsepower?

The Witness: As I remember it took 2600 horsepower at that time?

By Mr. Culton:

Q. And you are using 4,000 in the current one?

A. And we are using 4,000 now.

Mr. Littman: You mean you are using 4,000 now for the purposes of Exhibit 223?

The Witness: Yes, that is correct, 2600 horsepower.

Mr. Littman: Thank you.

By Mr. Culton:

Q. Now, your dehydration plant in Exhibits 223 and 224 is shown at \$60,000 whereas in the exhibit 42 it is shown at \$70,000. Do you recall what that difference was?

A. Yes, sir.

Q. All right.

A. The \$70,000 was based on a bid that was received from the Finor Company. Since that time we have done considerable experimenting on dehydration plant work, and we have come to the conclusion that our engineering department is capable of building a more suitable dehydration plant for our requirement, and it is estimated that we can do that work for \$60,000 and get the plant [fol. 9698] that we want, rather than pay the \$70,000 for the plant which was proposed.

Q. In other words, if at this time you were remaking Exhibit 42 you would use \$60,000 instead of the \$70,000 which you used there?

A. Yes, sir.

Q. You show in Exhibits 223 and 224 an item for looping existing lines, there being one of 3.5 miles and the other of four miles. Where would that looping be done?

There is an Exhibit No. 45 which you can probably describe that from, and you might hold it where Mr. Shattuck and counsel can see it, or they might come up here, and they and the Examiner could all see it, if you like.

A. The looping which is proposed covers the pipe shown to have been constructed—that would have been constructed in 1944 on the original estimate, and that particular location was chosen to enable wells connected to the present eight-inch line to produce gas at the required working pressures for the increased volume.

We have in our pipe yard at Hugoton at the present time some secondhand eight-inch pipe which I did not show because I just didn't have time to get the value of it, and we propose to come over and connect this original line with that eight inch pipe.

Q. The word "this" doesn't mean anything in the record.

[fol. 9699] Will you please give from section corners to section corners, or something like that?

A. Yes. The pipe extends from the end of the present 16-inch line, which is in the northeast quarter of Section 22, Township 33, Range 38, and extends to a point about 3 1/2 miles west to the approximate north half of Section 19, 33, 38, and the four miles, starts from the end of the 16-inch, northeast quarter of 22, 33, 38, and extends along the present eight-inch line in a northwesterly direction a distance of approximately four miles.

Trial Examiner: To say it another way, you are trying to increase your capacity immediately west of Hugoton, Kansas?

The Witness: Yes, sir. That is correct. And the reason that we picked that location is because there are so many wells now connected which are dropping off in pressure more rapidly than other wells in the field.

Trial Examiner: And the [reas] you have indicated on the map is a matter of six or eight square miles immediately west of Hugoton?

The Witness: That is correct.

By Mr. Culton:

Q. You said that, in doing this work, you had some eight-inch pipe that you thought you could use. Has the [fol. 9700] cost of that been included in the estimates in Exhibits 223 and 224?

A. No, sir. No allowance has been made.

Q. In other words, the money which you have been providing for in Exhibits 223 and 224 represents new money that would have to be put into the matter?

A. That is right.

Q. New pipe?

A. I think that the secondhand pipe would already be on the books of the company at some value, and the increase in the cost would just be construction, and it amounted to so little that I didn't put it in.

Q. So you are not taking into consideration, in this, either the value of that pipe or the cost of taking it up or the cost of replacing it?

A. No, sir. Neither have I shown that we are going to have to take any of that pipe out of the system.

12, and move the 16-inch line over to a portion of the system that the 12 will be removed from, in order to give us better capacity in the Panhandle field.

Q. In other words, this study was made as much for the information of those interested in the amounts of new steel which would be required as anything else?

A. Yes.

[fol. 9701] Q. That was one of the important things that you were considering? A. That is correct.

Q. Now, I notice that you have a less number of buildings required on Exhibit 223 and 224 than were required in your old Exhibit 42.

A. The number was cut down because the material situation had become as tight as it has, and the fact that we are not going to be able to build all of the buildings which were originally proposed will influence our operating cost to some extent, and that will be an increase of the operating cost.

[fol. 9707] By Mr. Culton:

Q. Mr. Hinton, I think this morning we had discussed the differences between the capital expenditures in 1942 as shown in your Exhibit No. 223 and the capital expenditures for the same years effected in your Exhibit No. 42.

Is there any change in the expenditures which you contemplate making in 1943 and those you had covered for 1943 in your Exhibit 42?

A. Yes, there is a change unless the present situation ends and it is possible to obtain the desired materials.

Q. You reduce the expenditures for 1943, do you not, as shown on Exhibits 223 and 224? A. Yes.

Q. Substantially below those you had provided for 1943 in your Exhibit No. 42?

A. That is correct. We reduced that, the major reduction being to limit the use of steel.

Q. Is there any additional capital expenditure provided for in Exhibit 224 for the year 1942 over and above those provided for in Exhibit 223? In other words, to meet the 228 million which are now required?

A. No, they are identical.

Q. I notice that for the 307,000, there is a total expenditure of \$1,335,000 in Exhibit 223 and, in Exhibit 224, that expenditure is shown as \$1,978,000.

A. I thought you were speaking of the year 1943.

Q. 1942.

A. Yes, there is a difference in the two expenditures.

Q. In order to meet the 338 million sales, what will you have to have by way of capital expenditures that will not be required to meet sales of 307 million?

A. There will have to be a 4,000 horsepower compressor station built near Santanta and a dehydration plant at that location and a telephone line from the present Liberal compressor station up to the proposed Santanta station.

Q. In other words, the Santanta station will have to be in contact with the line? A. Yes.

Q. So you can tell how to handle your pressures?

[fol. 9709] A. That is right.

Q. There would be no commercial station, telephone line there, that could be used?

A. That is my understanding. I did not investigate it but I had it investigated and that is the answer I got.

Q. Will you refer to Exhibit 45, the map of the future expenditures and tell us approximately where the Santanta station would be?

A. The proposed Santanta station will be in the northwest quarter of Section 28, Township 30, Range 34, Haskell County, Kansas, and it is shown on Exhibit 45 by a dotted triangle that it would eventually be a station location but, as it did not come within the 5½ year period covered in this study, it is not colored. It is just merely shown on there as a triangle at the present time.

Q. In other words, you had originally assumed it would be necessary to put that station in at a date after 1946? A. That is correct.

Q. But by the use of less steel and more horsepower, you have decided it would be necessary to put it in now if you meet these peaks? A. That is correct.

[fol. 9710]

Recross-Examination.

By Mr. Littman:

Q. Mr. Hinton, have any of the expenditures set forth in Exhibits 223 and 224 been as yet approved by the Board of Directors of Panhandle Eastern Pipe Line Company? A. Yes, sir.

Q. Which ones have been approved?

A. Should I identify those by item letter?

Q. Yes. A. Item (A) —

Q. (Interposing) Just a minute, you are referring to which exhibit? A. Exhibit No. 223.

Q. Exhibit No. 223, all right.

A. Item (A), item (B), item (C), one-half of item (D), item (E), item (F), item (G), now under construction, item (H) now under construction, one-half of item (I), item (J) has not been approved. Neither has item (K), nor (L), (M), and I am not sure about (N). Item (O) has been approved, and when I speak of approved, I mean that that is in the budget at this time and the money has been set aside for the use of this construction.

[fol. 9711] Q. Which items are under construction?

A. Item (G) and Item (H).

Q. The others are not under construction?

A. No. We have the pipe for the liners, for item (B). We have the pipe for item (A). We have the pipe for item (C) and as to the items which have not been approved in this recent study, there just has not been a chance to work up the budget for those for approval.

Q. In other words, roughly a little more than a half or approximately a half of the capital expenditures shown in Exhibit 223 have not been approved by the Board of Directors?

A. Yes, approximately half of the money involved.

Q. Have those items which you indicated were not as yet approved by the Board of Directors been submitted to the Board of Directors by way of an estimate or budget?

A. No, they have not and I think that the fuel requirement situation for war industries will govern whether they are submitted or not. If they are not submitted, why, it will mean that we will be supplying a much smaller market than is anticipated on the quantity shown at the top of Exhibit No. 223.

Q. In other words, items (J), (K), (L) and (M), at least, may never be submitted and may never be approved by the Board of Directors for aught that you know? [fol. 9712]

A. Not item (J). Items (K), (L) and (M) will depend upon the need for fuel for war industries.

Q. And those three items alone make up approximately half of these proposed capital expenditures for the year 1942 under the hypothesis stated in Exhibit 223. Is that right? A. Yes, sir.

Q. What is the fact as to item (J)? That item, office building Hugoton, has not yet been submitted to the Board of Directors, has it? A. I am not sure.

Q. Or did I misunderstand?

A. I just do not know whether that has been approved or not. I feel quite sure that it has not been disapproved by the Board because that portion of the budget, my understanding is, has not yet come up for approval.

Q. All right. How about the proposed expenditures estimated for the year 1943 in Exhibit 223 in the amount of \$65,262, have any of those items been submitted or approved by the Board of Directors?

A. No and, in all probability, they will not until the early part of 1943.

Q. In other words, no commitment has been made with respect to those?

A. I do not believe that any of the budget items are approved a year in advance in any case by the company. [fol. 9713]

Q. Now, let's look at Item (G) which is a large item in Exhibit 223 which provides for the installation of additional horsepower at Sneed in the amount of 2600 horsepower at a total cost of \$262,800. Have you as yet ordered the equipment?

A. It is not only ordered, the major part of it is on the location and the construction work has been going on for some time on the installation of the 2600 horsepower.

Q. You have the machines on hand?

A. Either on hand or shipped. It is quite definite that they are there. I have not been down there for a couple of weeks and I do not know whether they are in or not.

Q. What about Item (H), additional horsepower at Hansford in the amount of \$121,200. What is the fact as to that?

A. That is about the same as the Sneed station or Item (G). It is under construction at the present time and if the engines are not there at this time, they are probably on the way.

Q. What assurance, if any, do you have that you are going to be able to get compressor station equipment designated as Item (K), in line 13, for the compressor station near Hugoton, Kansas, shown here as 4000 horsepower and in the amount of \$552,560?

A. If it is decided that there is an urgent need for [fol. 9714] gas to be used as fuel in war industries, I think it is rather certain we can get the 4000 horsepower required there. Those will be 800 horsepower engines and they are more readily available than the larger engines at this time.

Q. Who has to decide that?

A. Well, I would say first it would be the W.P.B. and then, I cannot remember the name of the preference rating board.

Q. At any rate, some Governmental agency will have to give you priority before you can obtain that machine?

A. Absolutely.

Q. And you have not as yet received any such priority rating?

A. No, sir, this is too recent to have even made application for a preference rating.

Q. Now, let's look at Exhibit No. 224. Some of the items which you have already described are duplicated on this exhibit but perhaps you had better go on through each of the items on Exhibit No. 224 and tell us which ones have been approved by the Board of Directors of Panhandle Eastern and which have not.

Mr. Culton: Mr. Littman, I think you will find it will be a time saving proposition as there are only an addition of three or four items there so the same status would exist as to the remaining items.

[fol. 9715] That is true, isn't it, Mr. Hinton?

The Witness: Yes, that is true.

Mr. Culton: It is just the addition of three or four items on Exhibit No. 224 that are not on Exhibit 223.

Mr. Littman: Yes.

By Mr. Littman:

Q. I think you can start with line 14, Item (M). Suppose you take up the new items which appear in Exhibit No. 224.

A. Of which there are four.

Q. You know that better than I at this stage.

A. The first being Item (M), a compressor station to be constructed near Santanta and that is the same as the compressor station near Hugoton. It is a recent development, we might say, in our studies and there has been no approval and I feel quite sure there has been no application made for preference rating on the required horsepower.

Q. And it may never be installed, for all you know?

A. You mean during 1942 for the '42-'43 load?

Q. Yes.

A. I feel quite sure that it will eventually be installed but not for that year—what I mean is, it is going to be installed sometime but whether it is installed during the year 1942 to carry the '42-'43 load depends on what is decided as to the requirements for fuel for war industries. [fol. 9716] Q. You did not have any such item at all in your Exhibit No. 42 when you were last on the stand, did you?

A. No, sir, because we were basing our study on the economic method of development at that time.

Q. And within two years, let us say, it is altogether probable that you may revert to your so-called economic studies shown in Exhibit 42. Isn't that within the realm of possibility?

A. Yes, sir, we certainly hope so.

Q. Then it may never be installed?

A. If we furnish the 338 thousand M.c.f. daily sales, it will be installed because we cannot furnish it without it.

Q. With a capital "If," of course. If it is to be installed, it will be installed, of course, but you do not know whether it will ever be, do you?

A. Of course, the title of this exhibit was put on there to try to explain that the capital expenditures outlined here were based on the volumes that were given at the top of the exhibit.

Q. You started out with the premise that if and again I say a capital "If," if this amount is required in 1942, you will install, or in your opinion, the capital additions which you set forth here will be required.

A. Yes. If times were normal and things not so uncertain, there would be no change in the original exhibit. [fol. 9717] Q. All right. What about the next item,

"Telephone line" shown in line 15, item (N)?

A. That will be essential if the compressor station is built at Santanta.

Q. You know copper is pretty hard to get these days, don't you?

A. We have no idea of building a copper line. We are going to substitute steel. I think copper would be an utter impossibility.

Q. Has the telephone line been submitted to the Board of Directors for approval?

A. No further than Mr. Creveling, as far as I am concerned.

Q. How about the next item, "Dehydration plant near Santanta"? A. That is in the same class.

Q. "Loop existing lines Hugoton Field," which is the next item. What is the fact as to that?

A. That would also be placed in the same class.

Q. That is, the item has not been yet submitted to the Board of Directors for approval?

A. As far as I know, it has not. I know that Mr. Creveling has approved that method of obtaining the volume acquired.

Q. If certain things are to happen, he approves it?

[fol. 9718] A. Yes, and if the gas field does not suddenly become depleted.

Q. Now, how about the next item, "Purchase pickup trucks"? You were a little uncertain about that on Exhibit No. 223, were you not?

A. If we do not increase our load over the load which is anticipated, we will not have to purchase any one of those.

Q. Now, adding up these items that have not yet been submitted to the Board of Directors for approval and which are in the category of items concerning which you are uncertain as to when they will be installed, I secure the

amount of \$1,270,900-odd out of your estimate of \$1,978,000-odd. Is that about right?

A: Yes, that sounds about right to me.

Q: In other words, out of \$1,978,000-odd of estimated capital additions on Exhibit No. 224 for the year 1942, approximately only \$700,000 have been approved by the Board of Directors. Isn't that right?

A: That is correct. These things take time to go through the channels and I would say that these, in all probability, will not be submitted to the Board. I do not know how that works exactly but until Mr. Creveling would find out what the demand would be for fuel, these are largely dependent upon that. In other words, we can give them so much gas without any further capital expenditures or we can try to furnish needed fuel by making these additions.

Q: Now, with respect to the year 1943 the capital expenditures shown in Exhibit No. 224, I take it that no submission to the Board of Directors has as yet been made?

A: No, the only thing that has been done for the 1943 program is to secure some casing for the two wells.

Q: I take it from your testimony, Mr. Hinton, and I want you to correct me if I am wrong, you were merely given a mechanical job of estimating the capital additions that, in your opinion, would be required to make the deliveries shown in the captions of Exhibits 223 and 224 and to do so on the basis of the least amount of steel?

A: Steel and other materials in which a shortage appears at this time.

Q: In other words, you are not taking the responsibility for the philosophy of the exhibit but you have done a mechanical job of estimating the amount of capital requirement under the hypothesis given?

A: I do not know whether I would term that "philosophy" or not. I would say the volumes were given me and the problem was just as you stated it and to supply the volumes that were given me, these were the expenditures that would be required.

Q: You do not know whether the company is going to actually make these amounts of sales, do you?

[Feb. 9720] A: No, sir.

Q. Mr. Hinton, will you please give us, in a single statement, the formula which you used to convert the peak day sales amounts of 307,000 M.c.f. and 338,000 M.c.f. into the four annual amounts which you gave as gross amounts available at Liberal station?

A. You refer to the change of pressure basis?

Q. Yes, and to the line loss, company use.

The Witness: I believe that the most understandable way to do that would be to go through the same procedure which I did to arrive at those amounts.

[fol. 9721] I first took the 307,000 M.c.f. which is the estimated sales. The next thing is the addition of 16,880 M.c.f. which takes care of the fuel that is used east of Liberal. It is found by experience that the gasoline plant shrinkage will amount to 2,640 M.c.f., approximately, and that there will be an unaccounted amount of gas due to line loss of 1,540 M.c.f. which gives a total requirement of 328,060 M.c.f. and that is the requirement east of the Liberal compressor station.

To that amount we add, for fuel for the Sneed compressor station, 2,100 M.c.f.; fuel for the Hunsford station is 1,375 M.c.f. and fuel for the Hugoton station is 1,000 M.c.f. and the fuel for the Liberal station is 2,800 M.c.f. which gives a total of 335,335 M.c.f. daily requirement. That is multiplied times the capacity factor used, whether it be 70 or 90, and the product is multiplied times 365 days to arrive at the annual requirement.

Q. You mean if you are using a 70 per cent capacity factor, you take 70 per cent of 365 days and then multiply it by the 335,000 —

A. (Interposing) No, I take the 70 per cent of 335,335 and multiply that time 365 days. If it is 90 per cent, the answer is all the same but I never like to take 70 or 90 per cent of a year because it is hard to trace the figures back that way.

Q. But the results are the same?

[fol. 9722] A. That is right.

Q. Now, what pressure base do you have?

A. Those amounts which have been given are all on a 30 inches saturated pressure base which is equivalent to 14.73 pounds, approximately, that is, very close and to convert that to the 2 pound pressure base which is 16.4 pounds, it is necessary to divide 14.73 by 16.4 and that factor is applied to the amounts which have been given to arrive at the pressure base which is used in the production end.

Q. Will you please take the 338,000 M.c.f. peak day sales and give us the method applicable to that amount?

A. We start with the 338,000 M.c.f. To that we add the fuel requirement east of the Liberal compressor station, which is 22,130 M.c.f. The gasoline plant shrinkage for that amount will run 3,375 M.c.f. and the unaccounted for gas, due to line loss, will be 2,327 M.c.f. That gives us a sub-total of 365,832 M.c.f. which is required east of Liberal to supply a sale of 338,000. Then to the 365,832 M.c.f. we add the Liberal fuel in the amount of 3,080 M.c.f.; the Sneed fuel in the amount of 2,400 M.c.f.; the Hansford fuel in the amount of 1,375 M.c.f.; the Hugoton fuel in the amount of 1,000 M. c. f. and the Santanta fuel in the amount of 1,170 M.c.f. which gives us a total of 374,557 M.c.f., the amount which we are required to produce to supply a 338,000 M.c.f. sale.

[fol. 9723] Then, to find our annual requirement on a 70 per cent capacity factor, we multiply the 374,557 by 70 per cent and, in turn, by 365 days to get the annual estimate on a 14.73 pound pressure base. In other words, to convert to the production pressure base, we divide 14.73 by 16.4 and we obtain a factor of .89817 which is applied to the amounts given in any case and that gives us the requirement from the production end.

Q. That is 85,954,285 M.c.f. for the year?

A. On a 70 per cent capacity factor?

Q. That is the one you just gave us.

A. How many did you say, Mr. Littman?

Q. 85,954,285 M.c.f. per year.

A. That is correct.

Q. Now, in order to secure the amounts under the 90 per cent load factor, you used the same formula except that you applied 90 per cent instead of 70 per cent?

A. To the total daily requirement, that is correct. I think that we have the wrong figure there for the annual requirement, though. It is my understanding that we are talking about a 338,000 sale. That is the one we have just gone through.

Q. That is right.

A. And a 338,000 M. e. f. sale daily on a 70 per cent load factor gives us an amount of 95,699,033 M.e.f. on a 14.73 [fol. 9724] pound pressure base or 85,954,285 M.e.f. on a 2 pound pressure base or production base—

Mr. Culton: (Interposing) When you say 2 pound, you mean 16.4?

The Witness: Yes, that is atmosphere plus 2 pounds.

By Mr. Littman:

Q. And the figure I read of 85,954,285 M.e.f. is on the—

A. (Interposing) On the 2 pound base rather than the 8 ounce.

Q. And the latter base is the one which you use and did use in the Exhibit No. 42?

A. That is correct, yes, sir.

Q. Mr. Hinton, when you referred to your annual estimate as "Load conditions comparable" to Mr. Morton's estimates in Exhibit No. 40, you merely meant that the annual volumes were the same?

A. Yes. I did not state that properly and I appreciate your calling attention to it because it had nothing to do with the load factor at all. It was the annual requirement.

Q. Is it not true that in the load conditions which you have assumed the annual sales are larger in proportion to the system capacity than in Mr. Morton's Exhibit No. 40?

A. Yes, they are somewhat larger and I believe that you are referring to the 70 per cent capacity factor?

[fol. 9725] Q. That is right.

A. Of course, we know that 90 per cent is much larger.

Q. What provision has been made to hold the leases which were supposed to be perpetuated by the 19 wells

which you had proposed to drill per your Mem (M), page 27, of Exhibit 42?

A. As far as I actually know, there has been no move made but the leases which were at that time owned by Hagy, Harrington & Marsh have been sold to another company and it is possible that we will be able to make some type of deal with the other company. If not, to insure ourselves against an altogether loss there, we have gone out and taken additional acreage elsewhere to make up for these leases, if they are entirely lost to us.

Q. Well, when did you discover this? A. Discover what?

Q. That you could do without drilling these 19 wells?

A. If we did not put in the horsepower up in the Hugoton Field, we would have to have the 19 wells and the pipe line as we originally had it laid out.

[fol. 9726] By Mr. Chamberlain:

Q. Why would you have to have the 19 wells, Mr. Hinton?

A. To augment the supply which we now are able to put into the Liberal compressor station.

Mr. Culton: That is, you are able to if you get this additional expenditure, you mean?

The Witness: No, I mean under the original system, we plan to take an amount of gas from Oklahoma which is approximately equivalent to the increase that can be obtained by the use of horsepower in the Hugoton Field.

By Mr. Chamberlain:

Q. The 19 wells were to be in Texas County, Oklahoma?

A. Yes.

Q. Now, I think I understand your plan here to be a determination of a method of getting your supply on the basis of steel conservation, is that correct?

A. That is correct.

Q. Why do you have those three Texas wells included in 1942 if you are trying to conserve steel?

A. Just for insurance. To give you an example, during our peak load which occurred last winter when we were taking some 151 or 152 million out of Texas, we had on the line at that time 161 wells. The reason that we

did not have 110 on was because the other nine would not [fol. 9727] feed and we are experiencing, in some cases, very sharp pressure declines on our Texas wells and I did not feel that it would be safe not to drill any wells at all down there and that is the reason that we held it to three instead of five. We, I believe, are on the conservative side and yet on the safe side.

Trial Examiner: I do not recall, Mr. Culton, that any statement has been made on the record concerning any war [fol. 9728] time restrictive measures, that affect your drilling program?

Trial Examiner: There have been developments?

Mr. Culton: Yes, sir, not so much the drilling program as the furnishing of the material for the wells, obtaining the material.

That is correct, isn't it?

The Witness: There has been considerable along the lines of drilling also.

Trial Examiner: I have seen in the press statements concerning restrictions as to drilling for oil and I assumed that similar restrictions would obtain with reference to the development of gas. Is that true?

The Witness: That is correct.

Mr. Culton: Are you familiar with what those restrictions are? If so, will you give them?

The Witness: Pretty well. They come under P-68 and provide that no gas well can be drilled on acreage which is less than 640 acres; that it must be drilled approximately in the center of the lease and cannot be drilled on a lease which is more than twice as long as it is wide and they have had—I believe Mr. Littman was down to the hearing they had there on the local supply, no, it was Mr. Jones who was down there—they have had a meeting down [fol. 9729] there trying to cut down the size of the lease required because 640 acres in the Local Area there, that

would completely cure most of those patches of productive areas and they are trying to get a 40-acre spacing area worked out there now.

Mr. Culton: Would it now effect you substantially in the Hugoton area, is what I think the Examiner had in mind.

The Witness: Yes, it would, because we cannot go ahead and develop as economically as we would like to, that is, to cut down our delay rentals and decrease the overall cost of the gas to the extent we might like to because we cannot make an application for the use of materials and say that it was absolutely required that we do this, to furnish our market, say, do the drilling to furnish the market.

Trial Examiner: And the matter is controlled through the priorities regulations?

The Witness: That is correct. We file a notice of intention to drill in both Oklahoma and Texas. That is, they issue a permit and it is just a matter of getting the information into their offices. In Kansas, it is not even necessary to make out an application to drill.

Trial Examiner: Do the restrictions go so far as to deny the use of material you have on hand and in stock?

The Witness: Yes, sir.

[Col. 97308] Mr. Littman: These restrictions to which you have just referred are State, not Federal?

The Witness: That is correct, as far as the permits for drilling, but we are not permitted to use material which we have in the warehouse to drill wells that we could not swear were actually needed, without violation of the priority order as I understand it.

Trial Examiner: Now, you are referring not to State regulation but Federal regulation through the War Production Board?

The Witness: That is correct.

Trial Examiner: Through the Priorities Division?

[fol. 9736] Redirect Examination.

By Mr. Culton:

Q. Some reference was made, Mr. Hinton, to the leases which you have heretofore testified would be drilled if economically handled in order to protect some leases which have been top leased. A. Yes, sir.

Q. And you stated that there was a possibility that something might be worked out with the new owner of those leases. If it isn't, you think that, if you are not able to get the additional pipe required, the additional steel, there is a possibility that some of those leases might be lost: is that correct?

A. I think it quite probable that they will all be lost.

Q. But you will either lose the leases or you will have to make a trade with the present owners of some kind?

A. That is correct.

Trial Examiner: Your contracts are not such that the regulatory orders will relieve you from your obligations?

Mr. Culton: That is true, Mr. Examiner. As a lawyer, I might state that those [least] contracts provide that they absolutely terminate at a certain date unless production is then being had.

Top leases are made after that which would immediately [fol. 9737] become effective if that first lease, the lease held by us, terminates, and it is only production that can keep the lease alive after the—what we call—the primary term, and, of course, a new deal can't be made by the land owner now since he has executed a new lease to the top lessee.

Is that explanation sufficiently clear?

Trial Examiner: Yes.

By Mr. Culton:

Q. Mr. Hinton, certain exhibits—225, 226, 227, and 228—have been marked for identification. I will ask you to explain Exhibit 225, which is captioned "Estimate of operation and maintenance costs, South and west of Liberal Compressor Station, 307,000 M. c. f. continuous daily sales capacity, Operation at 70 per cent capacity factor,"

the first page being for the Panhandle field, and the second page for the Hagoton field.

Will you first explain the two columns under the heading "1942-1943" of Exhibit 225?

A. The amounts shown under the years 1942 and 1943 are the amounts which I estimate would be the cost to the company to operate and maintain the property south and west of Liberal.

[fol. 9738] It is a comparison of what the operating and maintenance cost would be if we were to develop as we desire, or if we are caused to develop as we have to with the shortage of material which is now being experienced.

Q. And will reach 307,000 M.c.f. at 70 per cent capacity factor? A. That is correct.

Q. Where are the principal differences between the economic expenditures resulting from economic construction and those less economic?

A. The principal difference in cost is in the royalties, in the delay rentals, and in the gas purchase costs, and in the increase of routine operating and maintenance costs which are caused by the installation of new compressor stations.

Q. I note on Exhibit 225 Page 23 the royalties are changed from \$232,000 to \$150,000.

A. You mean Line 23?

Q. Line 23, yes. A reduction in royalties? A. Yes.

Q. 1942 and 1943? A. Yes.

Q. And also a reduction in 1943-44. Why is that reduction in royalties?

A. That is caused by the drilling of additional wells [fol. 9739] in the Panhandle field.

Q. What do you mean by that?

A. As shown in the capital expenditures. In other words, if we would go ahead and develop, as I believe that the company should, to meet these market requirements, we would have, at the time which we would experience this load, have developed so that the amount of gas that we would be producing, which would be in excess of what we will be able to produce under the less economic expen-

ditures; would a [a] comparison of \$232,099 against \$160,523.

Q. In other words, by producing less of the gas your royalties are less: is that the point?

A. That is correct.

Q. Now, there is an increase in Line 25 in delay rentals, from \$4,932, as used under "Economic Expenditures," to \$11,031 on "Less Economic Expenditures." What is the cause of that increase in delay rentals?

A. That is because we would be forced to continue to hold those leases by the payment of delay rentals rather than by curing the lease by drilling.

Q. That represents the leases which you have heretofore assumed you would drill in Texas?

A. That is correct.

Q. And in order to hold those leases alive you were required to pay more delay rentals than you had anticipated? A. Yes, sir.

Q. Now, line 27 show an increase of \$113,000 in gas purchase costs.

Explain the reason for that.

A. That is because the percent that the purchase wells would participate in the Parhandle field, after we had made our desired development, would be less than it will be under the alternate or substitute method of development.

Q. There is a decrease shown in columns B and C, page 1, Exhibit 225, of some \$62,000 in royalties, but there is an increase in the amount of \$110,000 or \$113,000 in the expense for gas purchase costs, is that correct?

A. That is correct.

Q. That is due to shifting the balance between your purchased gas and your produced gas in Texas?

A. That is right.

Mr. Littman: Why is that necessary? Why are you going to shift—why are you going to make that shift?

The Witness: By the application of the proration formula under which the property is operated, each developed well has a certain participation in the total amount of gas that is taken from that field, and if we were permitted to

go ahead and drill the wells that we would choose to drill to meet this volume—market volume—why, the division of that gas in Texas would be in the following per cents:

[fol. 9741] We would be producing 68.77 per cent of the gas and would be buying 31.23 per cent of the gas, but inasmuch as we will not be able, in all probability, to get the material to develop, as we would desire, the division of the produced and purchased gas will be in the following per cents:

For the first year, which I assume will cover a portion of 1942 and 1943, we will be producing 56.47 per cent of our gas and will be buying 43.53 per cent, but, by the addition of two more wells, before we go into the next year's market, we will increase the amount that we will produce from 56.47 per cent to 57.27 per cent, and will decrease the amount that we will buy from 43.53 per cent to 42.73 per cent.

[fol. 9742] Q. There is also a difference in the production tax shown on Line 36 of Page 1, Exhibit 225, in that under your economic expenditure column B, the company's gross production tax in Texas would be \$65,698, whereas with less economic expenditures the gross production tax would be only \$40,590.

A. That is right. We would have a reduction of approximately \$25,000 in gross production tax.

Q. That is, had you anticipated that you would be able to drill the wells at the time that volume of gas would be required is that correct? A. That is correct.

Q. What was the difference in the first year, in the Panhandle field, between what the operating and maintenance expenses would be on an economic basis and on a less economic basis? A. It would be \$27,131.

Q. It would cost more in the Panhandle field than you have heretofore assumed under the same load?

A. Yes, sir.

Q. Annual load? A. Yes, sir.

Q. Now, will you pass to Page 2. Does that reflect the same situation as to the Hugoton field as it reflected [fol. 9743] on Page 1 as to the Panhandle field?

That is, is it prepared on the same general line?

A. The base used for the preparation is the same.

Q. What are the differences in the less economic expenditures and the economic expenditures, as reflected on Page 2?

What are the principal items of difference?

A. The principal items of difference are the operation of a compressor station near Hugoton, and the cost of purchased gas.

Q. There will be an item of \$23,000 for the maintenance of the two compressor stations, operation and maintenance of the two compressor stations; is that correct?

A. That is correct.

Q. And an increase in the cost of purchased gas from \$508,000 to \$931,000; is that correct?

A. No, sir. There will be an increase in the cost of purchased gas from \$293,498 to \$701,922.

Q. My eyes went crooked. You are right.

A. There will be a reduction in royalty of approximately a thousand dollars.

Q. And what will be the difference in the cost of the Hugoton field between operating with economic capital expenditures and the less economic expenditures?

A. It would be \$302,846. Four hundred is right— [fol. 9744] \$403,846.

Q. Then what would be the net increase in operation and maintenance cost be in the two fields for the first year in operating with what you consider economic expenditures and those less economic? A. \$429,977.

Q. In other words, your operation and maintenance expenses, if you attain a production of 397 million cubic feet daily sales capacity, operating at 70 per cent capacity factor, with the expenditures which you have heretofore described, would cost the company more than \$429,977, than would the cost have been had you been permitted to make the expenditures referred to in your Exhibit 42?

A. Yes, that is correct.

Q. Now, Exhibit 226; is that prepared along the same lines as Exhibit 225, only for an operation at 90 per cent capacity factor? A. That is correct.

Mr. Littman: —I would like to have the witness clarify one or two matters for me.

{fol. 9745} Mr. Hinton, where do you secure the figures in Exhibit No. 225, which appear in columns headed, "With Economic Expenditures"?

Are those figures taken from your Exhibit No. 43, schedules 3 and 4?

The Witness: Some of them are and some of them aren't. In other words, I—

Mr. Littman (interposing): That is what seems to have me confused.

The Witness (continuing): —I had to make a new estimate of what the expenses would be under each condition for this load.

Mr. Littman: Well, you had them already estimated—

The Witness: (interposing): No.

Mr. Littman (continuing): —in Exhibit 43, did you not?

The Witness: No, sir.

Mr. Littman: Then it—

The Witness (interposing): I had the same comparative type figure, but under a different load condition, and with the time element entering into the problem of the cost.

Mr. Littman: Different volumes of gas too: is that right?

The Witness: Yes; and I used the actual costs which we have on our books for the cost of these functions, as a {fol. 9746} base, but I used my judgment in what it would cost for each particular operation in each case under these conditions.

Mr. Littman: So that you can't take any of your columns headed, "With economic expenditures" and compare them with any of the schedules that appear in Exhibit No. 43 directly can you?

The Witness: Not directly, no sir, but they are the base which—that is, they are the base figures on which I based my judgment of revising the estimated cost of maintenance and operation in Exhibit 225.

Mr. Littman: Well, now, looking at schedule 4, page 1 of Exhibit 43, and comparing column—

The Witness (interposing): Which is that, Mr. Littman, please?

Mr. Littman: Estimate of operation and maintenance costs of west of Liberal, Panhandle field, estimated future load.

Now, I note in your column F for the year 1944, of that exhibit, your operation, your transmission operation expense is \$27,078, which is precisely the same as the similar item which appears in Exhibit 225 in Column B.

The Witness: Yes. And it should be approximately the same, because we would have the same number of miles of pipe line to operate.

[fol. 9747] Mr. Littman: Now, the next item "Maintenance" is \$13,530 in each of the exhibits?

The Witness: Yes.

Mr. Littman: Now, looking at the measurement amounts for the year 1944 in schedule 4, page 1, of Exhibit 43, the expense is \$21,528, which is the same as the amount which appears in Column B of Exhibit 225. Is that right?

The Witness: That is correct, and it should be so.

Mr. Littman: Now, the next one appears to show a considerable variance?

The Witness: Yes, sir.

Mr. Littman: Column F for the year 1944 Exhibit 43 schedule 4 shows—page 1—shows \$243,200 for compressor station operation and maintenance, as compared with \$95,859 in Column B of Exhibit 225. Now, what accounts for the difference there?

The Witness: I would say that the difference is accounted for in the fact that the original figure included a cost of 15 cents per M. c. f. for fuel which was used in the operation of the compressor station, and if you will remember we had considerable discussion about how that should be handled.

It is a washout, as far as regular accounting is concerned, but to bring out our picture more accurately I left the cost of fuel out altogether this time.

[fol. 9748] Mr. Littman: This time you did as we suggested you do?

The Witness: Yes.

Mr. Littman: In other words, take the cost of fuel out so as to avoid a possibility of a duplication?

The Witness: That is right, and I didn't want to get into another accounting argument, because I knew I would lose, so I just left it out.

Mr. Littman: Well, that saved us a lot of money here, didn't it?

That accounts for the paring down from \$243,000 to \$95,000 for that?

The Witness: Yes, sir.

Mr. Littman: Let's look at the next item which appears to be identical, to wit: cost of or expense for the production operation and maintenance.

The Witness: Right.

Mr. Littman: Now, you show \$36,250 in Column B of Exhibit 225, which is identical with the amount shown in your previous schedule, Exhibit 43?

The Witness: Yes, sir. That would be the same number of wells under approximately the same operating condition.

Mr. Littman: So far so good. Now, the next one is entitled: "Land and Lease. Operation, Royalties, Rents, Delay Rentals, Renewal Bonus."

Now, here is a considerable variation?

[fol. 9749] The Witness: Yes, sir. The original did not have the gas purchase costs, but inasmuch as we finally had it all together before we got through making exhibits, I carried the gas purchase costs in this total here.

Mr. Littman: In other words you did not include in the former exhibit—to wit: Exhibit No. 43—the cost of gas purchased, did you?

The Witness: No, sir.

Mr. Littman: You did include it after we made some computations?

The Witness: That is right.

Mr. Littman: And added them together?

The Witness: And I thought it would be handier for everybody concerned if it was put in here at this place.

Mr. Littman: I see. Well, but notwithstanding that, that is, excluding the \$650,209 of gas purchased, I believe there would still be a variance.

Let's look at the items. Your operation is the same under both the old and the new?

The Witness: Yes, sir.

Mr. Littman: Now, under the old schedule you had \$182,562 for royalties, whereas you now have \$232,099 for royalties?

The Witness: Yes, sir. The volume controls royalties, and the volume which we are talking about is the same as [fol. 9750] that which we would experience in the year 1946, approximately.

Mr. Culton: Rather than the year 1944?

The Witness: Yes.

Mr. Culton: Or '43, whichever one you are using?

The Witness: That is right.

Mr. Littman: Then the difference, at that juncture, is simply because of the increased volumes of gas?

The Witness: Right, and if you will notice, all the way through here our operating expenses have been estimated to be less, in almost every case, than they would have been if we would have encountered this load in 1946.

Mr. Littman: So your \$232,099 in Column B of Exhibit 225 for "Royalties" is the same as the amount shown in your former exhibit for the year 1946?

The Witness: That is a coincidence if it checks.

Mr. Littman: It comes out to the dollar.

The Witness: It would have to be a coincidence if it is correct.

[fol. 9751] It is not correct.

Mr. Littman: What is not correct?

The Witness: The amount shown. The \$232,099 is not correct.

Mr. Littman: What is the correct amount?

The Witness: It should be \$193,185.

Mr. Culton: It should be what?

The Witness: \$193,185 for the first year.

Mr. Littman: Instead of \$232,099?

The Witness: Yes, sir.

Mr. Littman: In other words you have just a slight increase over the 1944 figure in your previous exhibit: is that right?

The Witness: Yes. That is the way it would come about.

Mr. Littman: Now, the next figure of rents, \$325, is the same for 1944 under your old schedule?

The Witness: That is the same every year. That is office rent.

Mr. Littman: Now, delay rentals are the same, are they not?

[fol. 9752] The Witness: No, sir.

Mr. Littman: Under your old schedule and under your present schedule?

The Witness: To fit the time, yes.

Mr. Littman: Beg pardon?

The Witness: To fit the amount of development; you see, the \$4,932 would be the last delay rental we would pay before we completed our drilling.

Mr. Littman: Very well. So the next item of \$800 is the same in Column B of 225 as—

The Witness (interposing): That is right.

Mr. Littman (continuing) —as shown in your former exhibit—

Mr. Littman (continuing) —for the year 1944, is that right?

The Witness: That is right.

Mr. Littman: Very well. Now, so far it looks like you [fol. 9753] have only got about \$10,000 more of expenditures in Column B than you had for comparable items in your previous exhibit.

The Witness: Yes, sir.

Mr. Littman: Let's go to the next item of dehydration.

The Witness: No. Wait a minute. You didn't get to the gas purchased there.

Mr. Littman: Well, I mean excluding the gas purchased.

The Witness: Yes.

Mr. Littman: Because you didn't set forth that item in your other exhibit: to wit, Exhibit 43.

The Witness: That is right.

Mr. Littman: Let's go to the next item, the item of "Dehydration Plant; Sneed, Operation and Maintenance."

Now, the total of \$6,623 is approximately the same—well, it is the same as the amount which you show in your Exhibit 43, schedule 4, page 2, for the year 1943?

The Witness: Yes. I believe that that is just about correct too.

Mr. Littman: Why do you jump back to 1943 instead of going to 1944?

The Witness: Because the age of the station, the age of the plant, would be taken into consideration.

Mr. Littman: Not many dollars involved there—

The Witness: No.

[fol. 9754] Mr. Littman (continuing) —one way or the other?

The Witness: No, sir.

Mr. Littman: Let's go to taxes. Taxes are \$95,976 under Column B, Exhibit 225, as compared with \$81,955 for the year 1944 in schedule 4, Page 2, of Exhibit 43. What accounts for that difference?

The Witness: It means that the difference of approximately \$30,000 there—

The Witness: That is accounted for chiefly in gross production tax, and the gross production tax in the state of Texas runs into considerable money on any volume of gas, and the fact that we would be producing less gas cuts that down from \$65,698 to \$40,590, and the ad valorem taxes are also lower under the less economic expenditures, because we don't have as much property in the state.

By Mr. Cufon:

Q. Just for clarification, that difference in the gross production tax would be paid by the people from whom you purchased gas, since they would pay the gross production [fol. 9755] tax on it? A. No, sir. That is paid by us.

Q. Well, you charge it to them though? A. No, sir.

Q. Didn't you do that?

A. Oh, we can't charge the gross production tax, on the gas we produce, to somebody else.

Q. No, but then there would be more of it, more of the gross production tax—

A. (Interposing) The state of Texas would get the same amount of money. I see what you mean.

Q. More of it would be paid by your vendors than by you? A. That is right.

Mr. Culton: All right.

Mr. Littman: Let's look at the ad valorem tax. The amount is the same in the old Exhibit for 1944 as under your new exhibit 225, Column B—\$30,278?

The Witness: Yes, against \$25,610.

Mr. Littman: Where is the \$25,610? I don't find that.

The Witness: Under Column C, line 35.

Mr. Littman: I was looking at Column B all the while. Your ad valorem tax is the same under Column B as it was under the old setup?

The Witness: That would be the taxable property that [fol. 9756] we had constructed in the state at that time.

Mr. Littman: The gross production tax goes up about \$14,000, doesn't it?

The Witness: About \$25,000.

Mr. Culton: I think you are talking about two different things there.

The Witness: Are you on Exhibit 225?

Mr. Littman: Yes, sir. You have \$65,698?

The Witness: Yes, sir, under Column B. That is the way we would like to have it.

Mr. Littman: Now, for the year 1944, which seems to be the comparable year over in Schedule 4, Page 2, of Exhibit 43, you have \$51,677 for gross production taxes?

The Witness: Gross production tax is governed entirely by volume of gas which is produced by the company.

Mr. Littman: Produced by the company?

The Witness: Yes.

Mr. Littman: But you are going to produce less, aren't [fol. 9757] you, under this new setup?

The Witness: Yes, than we would if we would have made the capital expenditures that we would have desired to make to furnish this volume of gas.

What you are losing track of is the time element and the volume of gas that is to be handled.

Mr. Littman: All I wanted you to explain is why, in column B, you have \$65,698 for gross production tax in exhibit 225, as against \$51,677 in column F of schedule 4, page 2 of exhibit 43.

The Witness: The gross production tax in the state of Texas is governed by the value of the gas, and the way that is calculated is to take the total amount produced and value the working interest which we have in that gas.

That is, we have seven-eighths, so I take $87\frac{1}{2}$ per cent of the 41,262,000 which we expect to produce, and I value that gas at 3.126 cents and arrive at a total value and take 5.2 per cent of that value which is the state tax, and that is the way I obtain the amount shown under "Gross Production Tax," line 36, exhibit 225.

[fol. 9759] By Mr. Culton:

Q. Mr. Hinton, have you checked the computations as to lines 23 and 36, page 1 of exhibit 225, during the re- [fol. 9760] cess? A. Yes, sir.

Q. Are your original figures right or wrong on those?

A. The original figures are correct.

Q. In other words line 23, the royalties under column B, are properly shown at \$232,099, and the gross production tax at \$65,698? A. Yes, sir.

Q. What caused the confusion in your examination a while ago?

A. Well, I had made several trial calculations and I had not marked the sheet of my working paper which I used, and I referred to the wrong sheet of my working papers.

I have now marked the sheet which I used so there can be no further mistake.

Q. And that represents the royalties and the gross production tax on the volumes of gas which you would have liked to have been able to produce from Texas, with a daily sales capacity of 307 million, and operation of 70 per cent?

A. Yes, sir. That represents the amount which I believe that we would use under such load conditions, if it were possible to obtain needed material.

Q. Then from the two fields you would have an increase in operation and maintenance cost of \$429,977 by using the less economic method of capital expenditures, is [fol. 9761] that right?

A. Yes. That would be for the first year that we would experience this condition, which I assume would occur during the latter portion of 1942 and the first portion of 1943.

Q. Would there be any substantial difference the second year?

A. No substantial difference. It would be about \$700 further increase.

Mr. Littman: Now, Mr. Hinton, do I understand you to say that the volume of gas contemplated to be produced by the expenditures shown in column B of exhibit 225 is 60 million M. c. f.?

[fol. 9762] The Witness: Annually.

Mr. Littman: From the Panhandle field?

The Witness: Yes, sir.

Mr. Littman: And that is the precise amount of gas which you had originally expected to be produced in 1946 as per your exhibit 43?

The Witness: Right.

Mr. Littman: Now turn, if you will, to page 2 of schedule 4 of exhibit No. 43, and I call your attention to column H for the year 1946.

You show your grand total of operation and maintenance expenses to be \$725,317, is that right?

The Witness: Exclusive of the purchased gas.

Mr. Littman: And I want you to add to that the cost of gas purchased which is \$650,209. I am correct, am I not, when I state that that is the cost of gas purchased?

The Witness: That is correct.

Mr. Littman: What total do you get?

The Witness: \$1,376,526, and from that amount the power or the fuel at 15 cents per M. c. f. should be deducted from the Sneed and Hansford compressor stations to make it comparable to the amount shown on exhibit 225.

Mr. Littman: Suppose you deduct that, and let's see whether it is comparable.

The Witness: I obtain a figure of \$1,207,466 after deducting the amount of \$108,460 for fuel at Sneed, and the amount of \$60,600 for the fuel at Hansford compressor station, making a total of \$169,060, which is to be deducted from the \$1,376,526, leaving a comparative total of \$1,207,466, against \$1,189,009, which is shown under Column B of Exhibit 225, the difference being principally in the time element of higher operating pressures and lower maintenance and operating cost of the wells.

Mr. Littman: The difference to which you refer now is the difference between the \$1,207,466 and the \$1,189,009?

The Witness: That is correct.

Mr. Littman: A difference of approximately \$18,000?

The Witness: Yes, sir.

By Mr. Culton:

Q. In other words, if these economic expenditures were made earlier, the operating expenses would be less than as reflected in your former exhibit?

A. That is correct.

Q. And you have shown that lesser operating expenses in column B? A. Yes, sir.

Q. Of Exhibit 225?

A. That is right. And if they were to be made at a later date than shown on this exhibit they would be increased instead of decreased.

[fol. 9764] By Mr. Culton:

Q. Passing to Exhibit 226, I notice you show, for the Panhandle there, operating at 90 per cent capacity factor, 307,000 M. c. f. of continuous daily sales capacity, an expenditure in the "economic" column of \$1,200,852, and in the "less economic" column \$1,216,140, and that the expenditures in the "less economic" column, column C, are the same as those shown by operating at 70 per cent capacity?

A. Yes.

Q. Why is that?

A. Because we would be taking the same amount of gas from the Panhandle field under either condition.

Q. In other words, whether operating at 70 per cent factor or 90 per cent factor, you would take the same volumes of gas from the Panhandle field, and under the same conditions?

A. From the standpoint of protection of reserves it would be the proper method to take it from there as we have done.

Q. But what is the difference in the cost of taking from the Hugoton field, when taken at 90 per cent factor, over and above that when taken at a 70 per cent factor?

A. I would like to find my copy of that 226.

Q. 226 is not in that for some reason (handing).

[fol. 9765] A. That is for 309,000 M. c. f. at 90 per cent capacity factor?

Q. Yes.

A. We would have an increase in the cost, cash out of pocket, to Panhandle Eastern, of approximately \$620,000.

Q. Making a total difference in the cost to Panhandle Eastern, in the two fields, of how much?

A. \$637,023.

Q. And Exhibit 227, is that prepared along the same lines which show a continuous sales capacity of 338,000 M. c. f. with an operation at 70 per cent capacity factor?

A. That is correct.

Q. Is there any difference in the Panhandle field between the cost under those circumstances and the cost when operating at 307,000 M. c. f. continuous capacity and 90 per cent factor? A. No, sir.

Q. You take the same volumes of gas?

A. Same volumes of gas being produced under the same conditions.

Q. And what is the situation as to the Hugoton field?

A. The increase that will be encountered in the Hugoton field is slightly over \$500,000.

Q. Making a total difference of how much in the two fields?

[fol. 9766] A. \$523,955.

Q. Now, passing to Exhibit 228, purporting to show the estimated cost of operation and maintenance for 338,000 M. c. f. of continuous daily capacity, operation at 90 per cent capacity factor.

Is there any difference as to the cost in the Panhandle field on the previous bases? A. No, sir.

Q. You are still producing the same volume of gas from the Panhandle field, irrespective of which of these sales capacities is used: is that correct?

A. That is correct.

Q. And what is the increase in cost of producing 338,000 M. c. f. at 90 per cent capacity factor over what it would have been in the Hugoton field, had you been able to handle the economic expenditures?

A. About \$744,000.

Q. And the total in the two fields would be how much more? A. \$760,963.

Q. Now, are columns D and E in each of these exhibits 225, 226, 227, and 228, prepared along the same lines as columns B and C, except for a subsequent year?

A. Yes, they are.

Q. Are the differences in cost shown on the end of each [fol. 9767] exhibit?

A. Yes, and I believe itemized in sufficient detail to enable anyone to see where the increase or decrease in costs occur.

Q. In your opinion do the figures reflected on Exhibits 223 to 228 inclusive correctly reflect what they purport to reflect?

A. As nearly as I feel that it would be possible to estimate them.

Q. And were they prepared by you?

A. They were.

Mr. Culson: That is all.

Recross Examination:

By Mr. Littman:

Q. These figures that you show at the foot of Page 2 of each of exhibits 225, 226, 227, and 228, as representing the difference between the cost of operating under the so-called "less economic" method, as compared with the cost of operating under the so-called "economic" method, do not reflect the saving that will accrue by reason of the installation of considerably fewer capital additions, both with respect to rate of return and with respect to allowances for depreciation?

A. No, sir. They do not purport to show any such [fol. 9768] figure.

They are purely maintenance and operating figures, including the cost of purchased gas.

Y There is no allowance made in there for excess profits, income tax, depletion of reserves, amortization, or anything other than pure maintenance and operation costs.

Q. No consideration given to rate of return—

A. (Interposing) Executive salaries.

Q. (Continuing) —executive salaries, or the fact that your fixed overhead costs, such as administrative and general expenses will remain the same notwithstanding the increased volume of gas—nothing for that?

A. No, sir.

Q. And as you have said, no reflection of the effect of the differences in depreciation allowances, as between the so-called economic and less economic methods?

A. That is correct.

It is a cash out-of-pocket expenditure, is what it amounts to.

Q. For maintenance and operation?

A. For maintenance and operation.

Q. And nothing else?

A. And nothing else.

[fol. 9762] Redirect Examination.

By Mr. Carlton:

Q. In other words this merely shows the difference in operating and maintenance cost, if you substitute additional power for additional steel which you would otherwise be compelled to get the additional volumes of gas.

A. That is correct. If there would be no difference in the operation and maintenance cost, what then, we would have gone to horsepower in the first place, rather than to pipe lines, in our original study.

Q. Did you at that time make a study to determine whether or not it was more economic to go to horsepower or to steel pipe?

A. I don't believe that we made what you would call a regular study, but we did make a sufficient number of calculations to readily show that we had chosen the economic method of development.

Q. And this less economic method—under this less economic method of development—you will be limited in the portions of your reserves which you can develop within an early period of time?

A. That is correct, and the fact is we will have to go ahead and make, at a later date, practically all of the additional [fol. 9770] additions which we originally contemplated, and this is merely a temporary substitute, but it does not mean that the additions proposed will not have to be constructed at a later date.

Q. In other words, you are just switching some of the later expenditures to early years and the early expenditures to later years: is that correct? A. Yes.

Mr. Littman: Can you give us the year? You talk about years; what years?

The Witness: If I knew just exactly what the fuel requirements were to be for the war industries I think I could give you the year, within a year, but I do not know what that load would be at this time, and it would be pretty difficult to answer your question.

Mr. Littman: Neither does anybody else know.

The Witness: That is what I am getting at. In this uncertain time, why, that would be a difficult question to answer.

Trial Examiner: Mr. Hinton, in the preparation of these studies you have adopted a standard of peak day sales of 338,000 M.e.f. and 307,000 M.e.f. at respective load factors of 70 per cent and 90 per cent?

The Witness: Yes, sir.

Trial Examiner: Perhaps it will make this record more [fol. 9771] intelligible if you say why you have adopted this standard.

The Witness: No, I did not determine the volumes, but it was explained to me why the volumes were used, and I think that Mr. Burnham's testimony will show why we arrived at the volume of 307,000 Mef per day and 338,000 M.e.f. per day, rather than some other figure, and the understanding that I have, and the reason that these studies were called for was on the assumption that Panhandle Eastern Pipe Line Company will probably be called on to deliver gas in considerable quantities, which will be used at plants engaged in making materials for the war effort.

[fol. 9772] By Mr. Culton:

Q. Your jurisdiction is only from Hugoton south and west; is it not? A. From Liberal.

Q. From Liberal, I mean, south and west?

A. Yes, sir.

[fol. 9773] Recross Examination

By Mr. Chamberlain:

Q. Is it my understanding that in 1941 you purchased and produced about equal quantities of the gas which you sold?

A. Yes. That is approximately correct.

Q. Now, is it fair to say that, in the immediate future, you contemplate an increased production of which you can not get the same proportion out of Texas as you have been in the past? A. That is right.

Q. And that the changes that are shown on Exhibits 225 and 226 are because of being required to change the source of your production from that which it would have been had you been able to make the expenditures that you outlined in your former exhibits?

A. That is correct. It is the shift of the division of load between fields.

Q. Now, can you tell me—and I think perhaps you did and I didn't take it down—what percentage you had figured that you would furnish from Texas at the time of your Exhibit 42?

A. At that time, and basing the load increase upon the estimate furnished by Mr. Morton, we assumed that we [fol. 9774] would continue to divide the load between the two fields in approximately the same proportion as we have the past year, that being somewhere around 70 to 71 per cent of the total from the Panhandle field.

Q. Well, now, going to your exhibit 225, column B, will you tell me what amount of gas it is contemplated that you will produce in 1942-43, page 1? I refer to the Panhandle field; page 1.

A. I don't believe I understand you. You asked what amounts we were going to produce for the year?

Q. Yes. Let me ask it again. What I would like there would be the figures of what you contemplate producing and what you contemplate purchasing in that exhibit.

A. We estimate that we will produce —

A. (Continuing)—41,262,000 M.c.f.

Mr. Littman: 41,262,000?

The Witness: M.e.f.

[fol. 9775] Mr. Littman: That is, produced?

The Witness: Yes.

By Mr. Chamberlain:

Q. And you will purchase how much?

A. 18,738,000 M.e.f.

That is what we would do if we were able to get the material to add to our system.

Mr. Culton: The two together make 60 million, is that right?

The Witness: Yes, sir.

A. (Continuing) But what we are actually going to do with the shortage of material, in place of producing 41,262,000, we estimate that we will produce 28,537,417 M.e.f. and we will purchase 21,998,118 M.e.f. making a total of 50,535,535 M.e.f.

Mr. Littman: That is a different volume of gas, is it not?

The Witness: Yes. If we had the material to build to get to a market of this volume we would take 60 million feet a year from Texas, while we could, rather than being [fol. 9776] forced to cut back to 50,535,535 M.e.f.

By Mr. Chamberlain:

Q. Now, will you turn to page 2, exhibit 225, and give me similar figures for the Hugoton field?

A. If we were able to develop in the manner which we would like to—that is 307 at 70 per cent, isn't it?

Q. That is right.

A. (Continuing)—we would produce from the Hugoton field 10,128,114 M.e.f. as would be reflected in column B of Exhibit 225, and would purchase 6,825,542 M.e.f.

A. But operating in the method which is considered under the less economic method we will produce 10,094,364 M.c.f. and will purchase 16,323,757 M.c.f., making a total from the Hugoton field of 26,418,121 M.c.f. which would be taken from that field under the additions shown in Column C. By "additions" I mean additions to the property in the way of pipe lines and horsepower.

[fol. 9777] By Mr. Littman:—

Q. Will you give us the corresponding figures for columns D and E on page 2?

For the column—they will be the same, the volumes will be the same for D and E, the M.c.f. volume will be the same.

Q. Is the same true of the preceding page, namely page 1 of Exhibit 225? Will the volumes be the same—

A. (Interposing) No, sir.

Q. (Continuing)—for columns D and E as for columns B and C?

A. No, sir, they will not.

Q. Will you please give us the volumes for columns D and E?

A. Under the economic method of developing, they will be the same, but as we feel that we are going to add to the system the amount shown to be produced from the Texas field for column B would be 41,262,000, and the amount purchased 18,738,000.

Q. That is the same for column D as for column B?

A. Yes.

Q. Page 1 of exhibit 225?

A. Same for B as for D, but the amount for E is not the same as that for C.

[fol. 9778] Q. Will you give us that figure?

A. Yes. The amount we would produce, and which would be reflected in column E, would be 28,941,701 M.c.f. produced and 21,593,834 M.c.f. purchased.

Q. That gives you precisely the same total—

A. (Interposing) Yes, it would be the same volume.

Q. (Continuing)—as that for column C?

A. That would be the same volume from the Panhandle field, but the division between the purchased and produced changes.

Q. Very slightly at that?

A. By two wells. By the addition of the two wells, the influence that they would have.

[fol. 9784] C. H. M. BURNHAM was recalled as a witness, having been previously sworn, was further examined and testified as follows:

Direct Examination

By Mr. Culton:

Q. Mr. Burnham, exhibits 229, 230 and 231 have been marked for identification.

I will ask you if those exhibits were prepared by you.

A. They were prepared by me and, to some extent, under my direction.

Q. Do they correctly reflect the matters which they purport to reflect? A. They do.

[fol. 9785] Q. I will ask you to explain these exhibits, first taking Exhibit 230—we can go back to 229 later—and ask you to explain Exhibit 230, the occasion for your making the study, and what that exhibit shows.

A. As I have previously testified during this hearing, we are continually studying the loading on our system, the effect of different distributions of load, and the need for power, as evidenced by these studies, at the various compressor stations.

I was assigned the job of determining as accurately as possible the maximum quantity of gas which might be sold on a continuous basis when the system west of Zionsville, Indiana, is completely looped, and with the various compressor stations powered on an economic basis.

This study resulted in the answer shown on Exhibit No. 230.

In other words, when completely looped west of Zionsville, Indiana, and economically powered, Panhandle Eastern Pipe Line Company System, combined with that of

Michigan Gas Transmission Corporation will have a continuous daily delivery capacity of 338,000 M.c.f.

Q. What compressor units are required for that capacity? Where are they reflected on your exhibit 230?

A. They are reflected near the bottom of page 1 at the right-hand side, the additional compressor units that [fol. 9786] would be required.

Q. And what would be the aggregate cost of those compressor units?

A. The aggregate cost of those compressor units, including additions to the gasoline plant at Liberal compressor station, amounts to \$2,959,150.

Q. What additional pipe line construction would be needed in order to attain that capacity, and where is it reflected on your study?

A. The additional pipe line construction that would be required is shown on page 2 and consists of two loops in Indiana, or rather one loop in Indiana and one loop extending over into Ohio, and the completion of our loop construction in Kansas.

The loop in Ohio consists of 9.94 miles of 24-inch O.D. pipe on the discharge of Edgerton compressor station, and the loop in Indiana consists of 46.67 miles of 24-inch pipe on the discharge of Zionsville compressor station.

Q. That would make how much investment in pipe line by Michigan Gas Transmission?

A. \$1,494,504.

Q. And how much additional capital expenditures would be required for Michigan Gas Transmission by way of compressor station under that method?

A. We have no additional power required by Michigan [fol. 9787] Gas Transmission.

Q. No additional capacity for Michigan Gas Transmission Corporation, solely by reason of the looping which you have described?

A. That is correct.

Q. What looping would be required for the main line of Panhandle Eastern?

A. The looping required for the main line in Kansas will consist of 26.64 miles of 26-inch pipe on the discharge of Olpe compressor station—that is between Olpe and Louisburg compressor stations.

15.53 miles of 26-inch pipe between Haven and Olpe compressor stations.

20.19 miles of 26-inch pipe between Greensburg and Haven compressor stations, and 23.37 miles of 26-inch pipe between Greensburg and Liberal compressor stations.

Q. Making a total of how much for looping?

A. \$2,581,160.

Q. And this would require a total of how much for looping? A. \$4,075,664.

Q. Now, in addition to the additional compressor station and the loop lines, would any other expenditure be required on the main line system or on the system east of Liberal?

[fol. 9788] A. To complete the system and to make it possible to operate it on an economic as well as practical basis we feel that the system telephone line should be extended eastward to not only Dana but to Detroit.

Q. Which would necessitate a further expense of how much money?

A. A further expense of \$846,800.

Q. Making a total cost east of Liberal of how much for additional facilities in order to have economic production and transmission expenditures?

A. \$7,881,614.

Q. Now, did you also ascertain the expense of certain construction west of Liberal station in order to have the gas economically produced and transmitted?

A. Yes. — I consulted with Mr. Hinton and determined what field lines would be necessary, including expanding the trunk system into Texas.

Q. And were the figures that you obtained those that are reflected for such items in his original exhibit 42?

A. They are.

Q. Up to the time that volume of gas would be required?

A. That is correct.

Q. Did you consider the figures which he had there as reasonable? A. I did.

[fol. 9789] Q. And accounting only for the well lines, the trunk lines, the gathering lines, and the measuring stations, what additional investment would be required south and west of Liberal station?

A. \$3,660,923 in lines and measuring stations.

Q. Is that reflected on your exhibit 230?

A. On page 3.

Q. And to the extent that those items are listed in your exhibit, are they a duplication of similar items which appear in Mr. Hinton's exhibit No. 42?

A. They are.

Q. This would make a total investment of how much for additional capital expenditures over the entire system in order to have a continuous daily delivery capacity of 338 million cubic feet?

A. The figure which I will read is in addition to certain projects now already under construction, and amounts to \$11,542,537.

Q. And that, so far as the field is concerned, includes only lines and measuring stations?

A. That is correct.

Q. It does not include the compressor units or gas wells?

A. That is correct, and particularly does not include the two units we are now installing at Sneed and Hans- [fol. 9790] ford compressor stations.

Q. Now, have you, from this study, determined the amount of tonnage, by way of pipe requirements, that would be required if the line were completely looped and economically powered with economic production and transmission expenditures, so as to have a continuous daily delivery capacity of 338 million? A. I have.

Q. Is that reflected in your exhibit 230?

A. On page 4 of Exhibit 230 that is reflected.

Q. And will you explain page 4 to us?

A. Page 4 is a computation, or the results of a computation totalling the mileage of pipe involved, and determining from it the total tons of pipe.

As will be noted the Michigan Gas Transmission will be required to install 11,820 tons of pipe in Indiana and Ohio.

The Panhandle Eastern Pipe Line Company will be required to install in Kansas, along the main line, 17,502 tons of pipe.